Revised Explanatory Notes Relating to Income Tax

Published by
The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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Canada

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These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act*, the *Income Tax Application Rules* and two related statutes. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

PREFACE

These explanatory notes relate to proposed amendments to the *Income Tax Act*, the *Income Tax Application Rules* and two related statutes. In conjunction with notes released in July, November and December 1999, these notes describe these proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin
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REVISED EXPLANATORY NOTES

June 2000

The following notes contain revisions to notes relating to income tax that were previously released, as well as notes on amendments to sections 19 and 19.01 of the *Income Tax Act*. Previous notes accompanied the following News Releases:

99-067 Clarifying Amendments Regarding Tax Treatment of Resource Expenditures (July 23, 1999)

99-102 Draft Technical Income Tax Amendments Released (November 30, 1999)

99-112 Revised Taxpayer Migration and Trusts Proposals Released (December 17, 1999)

Clause 3

Inventory

Removing Property from Inventory

ITA
10(12)

The first paragraph of the note on this subsection is replaced by the following:

New subsection 10(12) of the Act applies to a non-resident taxpayer who ceases to use a property, described in the inventory of a business or part of a business that is carried on by the taxpayer in Canada, otherwise than by a disposition of the property. For example, subsection 10(12) applies if a non-resident taxpayer removes a property from the inventory of a business or part of a business carried on in Canada and adds that property to the inventory of a business or part of a business carried on by the taxpayer in another country. The time at which the taxpayer ceases to use the property in connection

with a business or part of a business in Canada is referred to in this note as the "particular time".

Adding Property to Inventory

ITA
10(13)

The first paragraph of the note on this subsection is replaced by the following:

New subsection 10(13) of the Act applies to a non-resident taxpayer who adds a property (otherwise than by acquiring the property) to the inventory of a business or part of a business that is carried on in Canada by the taxpayer. For example, new subsection 10(13) applies if a taxpayer removes a property from the inventory of a business or part of a business carried on in another country and adds that property to the inventory of a business or part of a business carried on in Canada by the taxpayer. The time at which the taxpayer adds the property to the inventory of the business or part of a business in Canada is referred to in this note as the "particular time".

Clause 6

The note on subsection 17(11.1) is replaced by the following:

Special Rules – Related Person Determinations and Back-to-Back Loans

ITA
17(11.1) and (11.2)

New subsection 17(11.1) provides that, in determining whether two persons are related to each other for the purpose of section 17, certain rights referred to in paragraph 251(5)(*b*) of the Act, such as rights to acquire shares of the capital stock of a corporation, are to be ignored to the extent that, under the laws of the country in which the corporation was formed or last continued or exists that govern foreign ownership or control of the corporation, the holder of the rights is prohibited from exercising the rights.

New subsection 17(11.2) provides a rule for back-to-back loans that is to apply for the purpose of paragraph 17(3)(*b*) of the Act. Where an initial lender makes a loan to an intermediate lender and that intermediate lender loans funds to the intended borrower because of that loan by the initial lender, the loan by the intermediate lender to the intended borrower is deemed to have been made by the initial lender and not by the intermediate lender to the extent of the loan made by the initial lender and under the terms and conditions established by the intermediate lender and the intended borrower.

These amendments to subsections 17(11.1) and (11.2) apply to taxation years that begin after February 23, 1998.

Exempt Loan or Transfer

ITA
17(15)

Subsection 17(15) of the Act contains definitions that apply for the purposes of section 17 of the Act, including the definition "exempt loan or transfer" which is relevant for the purpose of subsection 17(2) of the Act. Subsection 17(2) does not apply to an exempt loan or transfer of property.

The definition "exempt loan or transfer" is amended to include a transfer of property by a corporation resident in Canada by way of the payment of a dividend to a shareholder or the reduction of the paid-up capital of shares of the corporation.

This amendment applies to taxation years that begin after February 23, 1998.

Subclause 7(1)

Limitation re Prepaid Expenses

ITA
18(9)(*a*)(ii)

The last paragraph of the note on this subparagraph is replaced by the following:

This amendment applies to taxation years that begin after 1999 and, where a taxpayer so elects in writing with respect to both it and new subsection 18(9.02), to the taxpayer's taxation years that end after 1997. The election is to be filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxation year in which this amendment receives Royal Assent.

Subclause 7(2)

Application of Subsection (9) to Insurers

ITA
18(9.02)

The last paragraph of the note on this subsection is replaced by the following:

This amendment applies to taxation years that begin after 1999 and, where a taxpayer so elects in writing with respect to both it and amended subparagraph 18(9)(*a*)(ii), to the taxpayer's taxation years that end after 1997. The election is to be filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxation year in which this amendment receives Royal Assent.

Clauses 9 and 10

Limitation re Advertising Expenses

ITA
19 and 19.01

Section 19 of the Act precludes the deduction of advertising expenses to the extent that the expenses are incurred for advertisements directed at the Canadian market and placed in a newspaper or periodical that does not meet certain Canadian ownership criteria.

Pursuant to the Canada-U.S. Agreement of June 3, 1999 regarding periodicals, section 19 of the Act is amended to exclude advertisements in periodicals from the application of section 19. Instead, new section 19.01 of the Act permits full deductibility of expenses for advertisements published in issues of periodicals that contain at least 80% original editorial content, and 50% deductibility for advertising expenses in other periodicals, regardless of the ownership of the periodical.

These amendments apply to advertisements in issues of periodicals published after May 2000.

In addition, new subsection 19(5.01) provides an extended meaning of "Canadian citizen", in order to ensure that Canadian pension funds and certain other entities that may own Canadian newspapers are considered to be Canadian citizens for the purpose of the ownership requirements of section 19. This amendment applies from July 1996. For periodicals, the amendment applies from July 1996 to May 2000, after which nationality of ownership ceases to be relevant in the context of periodicals.

Clause 13

Farming or Fishing Business – Non-resident

ITA
28(4) and (4.1)

The third paragraph of the note on these subsections is replaced by the following:

With the addition of new subsection 10(12) and the amendment of section 128.1 of the Act (changes in residence), subsection 28(4.1) has become redundant, and is repealed with application after December 23, 1998.

Clause 14

Capital Losses – General Rules

ITA
40

Section 40 of the Act provides rules for determining a taxpayer's gain or loss from the disposition of a property.

Losses of Former Resident

ITA
40(3.7)

New subsection 40(3.7) of the Act is a "stop-loss" rule that may reduce the loss of an individual from the disposition of a property if the individual disposes of the property at any time after having ceased to be resident in Canada. In general terms, this stop-loss rule applies where an individual has received dividends in respect of a property (whether a share, an interest in a partnership or an interest in a trust) during the period of non-residence that begins after the individual last acquired the property.

The Act already includes, in section 112 and related provisions, a comprehensive stop-loss system for corporations. Instead of

duplicating that system, new subsection 40(3.7) adapts it to apply to losses otherwise realized by individuals on dispositions of property after they ceased to be resident in Canada, regardless of whether they are resident in Canada at the time of such dispositions.

For the purposes of applying subsections 100(4), 107(1) and 112(3) to (3.32) and (7) of the Act, new subsection 40(3.7) deems an individual to be a corporation in respect of dividends received in respect of a property after the last time the individual acquired the property and while the individual was non-resident, and deems any taxable dividends received by the individual during that period to have been deductible under section 112 when received. The effect of this is that some or all dividends received while non-resident may reduce the individual's loss on a share, partnership interest or trust interest.

New subsection 40(3.7) applies to dispositions of property that occur after December 23, 1998 by individuals who cease to be resident in Canada after October 1, 1996.

Clause 15

Part Dispositions

ITA
43

Section 43 of the Act is a rule governing the disposition of a part of a property. For the purpose of computing a taxpayer's gain or loss from the disposition of a part of a property, a portion of the adjusted cost base (ACB) of the whole property must be allocated to the part on a reasonable basis.

ITA
43(1)

Existing section 43 is renumbered as subsection 43(1) strictly as a consequence of the introduction of new subsections 43(2) and (3). This amendment applies after February 27, 1995.

ITA
43(2)

New subsection 43(2) of the Act applies where the part of a property disposed of is a servitude, covenant or easement to which land is subject. The 1995 budget introduced enhanced incentives for the donation of ecologically sensitive land to the Government of Canada, a provincial government, a Canadian municipality or an approved registered charity established for the purpose of protecting Canada's environmental heritage. Donations from individuals are eligible for the charitable donations tax credit (section 118.1 of the Act), while those from corporations are eligible for deduction from income (section 110.1 of the Act). Besides transfers of title, landowners are able to donate covenants, easements and servitudes established under common law, the civil law of the province of Quebec, or the law of other provinces allowing for their establishment.

Normally the value of a donated property is determined to be the price that a purchaser would pay for the property on the open market. As there is no established market for covenants, easements and servitudes, the fair market value of such restrictions on land use is difficult to determine. To provide greater certainty in making these valuations, the 1997 budget introduced a measure to deem the value of these gifts to be not less than the resulting decrease in the value of the land. That measure was implemented with application to gifts made after February 27, 1995.

Like other capital property, the adjusted cost base (ACB) of a covenant, easement or servitude is also relevant in calculating the capital gain or loss that may arise on disposition. To provide taxpayers greater certainty in making this calculation, new subsection 43(2) ensures that a portion of the ACB of the land to which the covenant, easement or servitude relates is to be allocated to the donated covenant, easement or servitude. For this purpose, the allocation of the ACB of the land to the gift is calculated in proportion to the percentage decrease in the value of the land as a result of the donation.

This amendment applies in respect of gifts made after February 27, 1995.

ITA
43(3)

New subsection 43(3) applies where part of a capital interest in a trust would, but for paragraph (*h*) or (*i*) of the definition "disposition" in subsection 248(1), be disposed of solely because of a satisfaction by the trust of a right to enforce a payment from the trust. No portion of the ACB of the taxpayer's capital interest is allocated to such a right. Accordingly, the ACB to the taxpayer of the remaining part of the taxpayer's capital interest in the trust is not reduced after the satisfaction of such a right. This amendment applies to satisfactions of rights that occur after 1999.

EXAMPLE

Joseph buys 1,000 units of XYZ Mutual Fund on December 23, 2000 for $10,000. XYZ has not made an election under subsection 132.11(1) to have a December 15 year end. XYZ makes $400 of its income for its 2000 taxation year payable to Joseph on December 31, 2000. However, without making any cash distribution of the income, XYZ issues 42 additional units on that date in satisfaction of the $400 of income payable. In November 2001, Joseph disposes of his 1,042 units for $10,700.

Results:

1. Under subsection 104(13), Joseph is required to include $400 in computing his income for the 2000 taxation year.

2. The right to enforce the payment of the distribution is treated as part of Joseph's capital interest in the trust under subsection 108(1). However, under paragraphs (h) and (i) of the definition "disposition" in subsection 248(1), there is no disposition of that part of the capital interest on the satisfaction of the right.

3. Under subsection 43(3), no part of the ACB of the original interest is allocated to the right to the income payable when the right is satisfied. Without taking into account the identical properties rule in subsection 47(1), this ensures that the ACB of Joseph's original 1,000 units will remain $10,000 once the right to income is satisfied, notwithstanding that Joseph acquired the units late in the 2000 taxation year.

4. The 42 additional units issued in satisfaction of the right to income are acquired at a cost of $400 because new subsection 248(25.3) ensures that the cost of the units issued directly in satisfaction of the income payable is equal to that amount. Consequently, the total ACB of the 1,042 units at the time of the disposition is $10,400.

5. Consequently, the capital gain realized on the subsequent disposition of all of the units is $300.

The introduction of subsection 43(3) is part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice. Other related amendments include the repeal of subsection 52(6), amendments to subsections 107(2) and (2.1), the amended definition of "capital interest" in subsection 108(1), paragraphs (*d*), (*h*) and (*i*) of the definition "disposition" in subsection 248(1) and new subsections 248(25.3) and (25.4). For further detail, see the commentary on those provisions.

Clause 20

Cost of Certain Property

ITA
52(1) and (1.1)

Subject to a number of exceptions, subsection 52(1) of the Act provides that, where an amount in respect of the value of a property has been included in computing a taxpayer's income, that amount is added in determining the cost to the taxpayer of the property for the purposes of determining capital gains and losses in respect of the property. Subsection 52(1.1) provides a similar rule in respect of taxable Canadian property of non-residents, except that it refers to a taxpayer's taxable income earned in Canada (as well as any amount subject to Part XIII withholding tax) instead of a taxpayer's income. These subsections do not apply to rights to enforce payments from a trust that are described in subsection 52(6).

Subsection 52(1) is amended and subsection 52(1.1) is repealed so that subsection 52(1) applies to all taxpayers, whether resident in Canada or not. Amended subsection 52(1) generally applies where a taxpayer acquired property and an amount in respect of its value was included in computing the taxpayer's income for a taxation year throughout which the taxpayer was resident in Canada (or in computing a non-resident taxpayer's taxable income earned in Canada under section 115, taxable income under section 114 or an amount from which tax is withheld under Part XIII).

The exceptions in existing subsection 52(1) also generally apply for the purposes of amended subsection 52(1). However, the exception relating to subsection 52(6) is eliminated because of the repeal of that subsection (as described in the commentary below). Instead, amended subsection 52(1) excepts property that is a beneficiary's right to enforce payments by a trust or that is acquired in satisfaction of a beneficiary's "capital interest" in the trust (as defined in amended subsection 108(1)).

These amendments apply after 1999, except with respect to property that is acquired before 2000 and disposed of before March 2000.

ITA
52(6)

Subsection 52(6) of the Act provides that, where a right to enforce payment by a trust of an amount out of the trust's capital gains or income (determined without reference to the provisions of the Act) for the trust's taxation year is acquired by a trust beneficiary in the year, the beneficiary's cost of the right is the amount that became so payable. This ensures that there is generally no capital gain realized where a payment is made in satisfaction of such a right.

Subsection 52(6) is being repealed. Instead, rights to which subsection 52(6) apply are now generally treated as part of a taxpayer's "income interest" or "capital interest" in a trust (as those expressions are defined in subsection 108(1)). Because of new paragraphs (*h*) and (*i*) of the definition "disposition" in subsection 248(1), where the right is part of a taxpayer's capital interest in a trust, the satisfaction of the right by way of a distribution by the trust will generally not constitute a disposition of that interest. In addition, under existing paragraph 53(2)(*h*), a distribution in satisfaction of

such a right generally will not result in a reduction of the adjusted cost base of that interest. In the event that such a right is capitalized by way of the issue of new trust units, new subsection 248(25.3) expressly provides for the cost of the new units. Where a taxpayer's right to enforce payment of an amount is disposed of to a third party prior to the right being satisfied by the trust, new subsection 248(25.4) provides, where the requirements of that subsection are met, an increase in the cost of the taxpayer's capital interest in the trust.

The repeal of subsection 52(6) and the related amendments (described above) are designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice.

The repeal of subsection 52(6) applies after 1999, except with respect to property that is acquired before 2000 and disposed of before March 2000.

Clause 21

Adjustments to Cost of Certain Property

ITA
53(2)(*i*) and (*j*)

The first paragraph of the note on these paragraphs is replaced by the following:

Paragraphs 53(2)(*i*) and (*j*) of the Act set out certain reductions required to be made in determining the adjusted cost base (ACB) of a capital interest in a non-resident trust (including a unit of a non-resident unit trust) acquired by a purchaser. The ACB reduction in respect of a capital interest in such a trust occurs, in general terms, where the purchaser acquired the interest from a non-resident person and assets of the trust consist primarily of any combination of taxable Canadian properties, Canadian resource properties, timber resource properties and income interests in trusts resident in Canada. The ACB reduction reduces the overall tax advantages associated with the sale of such capital interests by reducing the ACB to the purchaser of

the capital interest. The ACB reduction takes into account the deferral of the recognition of gains on such properties that used to result when a capital interest in a trust holding such properties (rather than the underlying properties) was sold by a non-resident person.

Clause 22

ITA
54

"principal residence"

The following is added at the end of the note on this definition:

This amendment also reflects changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act.*

Clause 23

Avoidance

Items 2) and 3) in the first paragraph of the note on the definition "specified corporation" in subsection 55(1) are replaced by the following:

2) shares of the distributing corporation must be exchanged for shares of another corporation (an "acquiror") in an exchange to which the definition "permitted exchange" in subsection 55(1) of the Act would apply if the definition "permitted exchange" were read without reference to paragraph (*a*) and subparagraph (*b*)(ii) thereof;

3) the distributing corporation must not make a distribution to a corporation other than an acquiror after 1998 and before the day that is three years after the day on which the distributing corporation shares were exchanged in a transaction referred to in 2) above; and

Distribution by a Specified Corporation

ITA
55(3.02)

The note on this subsection is replaced by the following:

New subsection 55(3.02) of the Act provides that where the distribution is by a "specified corporation" to an acquiror described in the definition "specified corporation" in subsection 55(1), the definition "distribution" in subsection 55(1) is to be read as if the reference in that definition to "each type of property" were read as "property" and to "property of that type" were read as "property". These changes ensure that divisive reorganizations, commonly known as "butterfly reorganizations", of specified corporations will be required to effect a proportionate distribution of the overall property of the corporation undergoing the divisive reorganization rather than of each type of property. subsection 55(3.02) applies to transfers of property that occur after 1998.

Clause 26

Exploration and Development Expenses

ITA
66

Section 66 of the Act provides rules with respect to Canadian and foreign exploration and development expenses.

Foreign Exploration and Development Expenses (FEDE)

ITA
66(4)(*b*)(i.1)

New subparagraph 66(4)(*b*)(i.1) of the Act is introduced to allow the full amount of a taxpayer's undeducted FEDE balance to be deducted in the event that the taxpayer ceases to be resident in Canada. This measure is consistent with existing income tax rules which allow emigrating taxpayers to claim a terminal loss on depreciable property as a consequence of deemed dispositions under paragraph 128.1(4)(*b*) of the Act.

The amendment, which applies to the 1995 and subsequent taxation years, will allow the FEDE deduction to be claimed for the last taxation year throughout which a taxpayer is resident in Canada. (Under paragraph 128.1(4)(*a*) of the Act, a new taxation year for a corporate taxpayer starts at the time that the taxpayer ceases to be resident in Canada.)

Clause 27

ITA
66.1(6)

"Canadian exploration expense"

Subsections 66.1(2) and (3) of the Act allow a taxpayer a deduction for a taxation year of up to 100 per cent of its cumulative Canadian exploration expense (cumulative CEE) at the end of the year. The definitions of CEE and cumulative CEE are contained in subsection 66.1(6).

Under subparagraph (*d*)(i) of the CEE definition, CEE includes a taxpayer's expenses incurred in a taxation year in drilling or completing an oil or gas well in Canada, provided that the well resulted in the discovery of a natural accumulation of petroleum or natural gas and the discovery occurred within six months after the end of the year. If such a discovery occurs later, subsection 66.1(9) generally allows for the expenditure to be treated as CEE incurred at the time of the discovery.

Subparagraph (*d*)(i) of the CEE definition was reviewed in the decision of the Tax Court of Canada in *Resman Holdings Limited and Dex Resources Limited v. Her Majesty the Queen,* 98 DTC 1999. The Tax Court's decision stood for the proposition that the costs of a step-out well can qualify as CEE under this subparagraph, even though the well was being drilled merely to establish the extent of an already-known pool of oil. The result in the case was surprising, given that the consistent practice of the industry was that the cost of step-out wells was treated as Canadian development expense rather than CEE. The Tax Court's decision was reversed by the Federal Court of Appeal in a judgment delivered on May 24, 2000.

Subparagraph (*d*)(i) of the CEE definition and paragraph 66.1(9)(*a*) are amended to confirm that the costs of drilling or completing a well qualify as CEE under those provisions only in the event that the drilling or completing of the well resulted in the initial discovery that a natural underground reservoir contains petroleum or natural gas. These amendments apply to expenses incurred after March 1987.

Paragraph (*k*.1) of the CEE definition is introduced to clarify that a taxpayer's CEE does not include the cost to the taxpayer of any depreciable property of a prescribed class. This amendment, as well as the related amendment to the definition "Canadian development expense", is for greater certainty. It responds to an issue raised by the decision of the Tax Court of Canada in *Robert Phénix v. Her Majesty the Queen*, 97 DTC 1228, which is currently under appeal. This amendment applies to property acquired after 1987. Paragraph (*k*.1) complements the wording in existing paragraph (*l*) of the CEE definition, with the result that both paragraphs provide for the same exclusions with regard to property acquired after December 5, 1996.

It should be noted that new paragraph (*k*.1), unlike existing paragraph (*l*), does not explicitly exempt a "Canadian renewable and conservation expense" (CRCE) from being excluded from CEE. The explicit exemption is not considered necessary, since proposed paragraph 1102(1)(*a*.1) of the *Income Tax Regulations* results in any CRCE not being considered to be included in the capital cost of depreciable property.

These amendments apply, with necessary minor technical modifications to take into account the restructuring of subsection 66.1(6), to the version of the CEE definition in force prior to the

enactment of the Revised Statutes of Canada, 1985, Fifth Supplement. Subsection 79(1) of the *Income Tax Application Rules* contains a rule to this effect.

Clause 28

Canadian Development Expense

The third paragraph of the note for "Canadian development expense" in subsection 66.2(5) is replaced by the following:

This amendment applies to property acquired after 1987. Paragraph (*i*.1) complements the wording in existing paragraph (*j*) of the CDE definition, with the result that both paragraphs provide for the same exclusion with regard to property acquired after December 5, 1996.

Clause 31

Inadequate Considerations

ITA
69(5)(*c*)

Subsection 69(5) of the Act ensures that where property is appropriated by a shareholder on the winding-up of a corporation, the property is treated as having been transferred at its fair market value with the consequent recognition on the transfer of any resulting income or loss. For this purpose, paragraph 69(5)(*c*) provides that subsections 52(1), (1.1) and (2) do not apply for the purposes of determining the cost to the shareholder of the property transferred.

Paragraph 69(5)(*c*) is amended to remove the reference to subsection 52(1.1), strictly consequential on the repeal of that subsection.

This amendment applies to dispositions that occur after 1999.

Clause 32

Death of a Taxpayer

ITA
70(5.3)

Subsection 70(5) of the Act provides for the deemed disposition of a taxpayer's capital property on the taxpayer's death for proceeds equal to the property's fair market value immediately before the death. In the event that the property includes shares and there was a life insurance policy under which the taxpayer's life was insured, the fair market value of the shares is determined under subsection 70(5.3) as if the value of the policy were the policy's cash surrender value immediately before the taxpayer's death. The purpose of subsection 70(5.3) is to ensure that life insurance proceeds payable as a consequence of death are not reflected in share value and therefore do not give rise to a capital gain on death.

Existing subsection 104(4) provides, in certain cases specified, for a deemed disposition of capital property (which includes shares) on the death of a taxpayer for proceeds equal to the property's fair market value. Existing section 128.1 also provides, in certain cases, that property (including shares) is deemed to be disposed of by an individual for its fair market value in the event that the individual becomes or ceases to be resident in Canada.

Subsection 70(5.3) is amended so that it applies for the purposes of subsection 104(4) and section 128.1.

Subsection 70(5.3) is also amended so that it applies in respect of property deemed to be disposed of as a consequence of a particular individual's death or change of residence where the relevant insurance policy insures the life of another individual (e.g., the spouse of the particular individual) with whom the particular individual does not deal at arm's length.

As a consequence of these amendments, where property is deemed by subsection 104(4) to have been disposed of by a trust as a consequence of the death of a particular individual and there is a life insurance policy under which the particular individual's life (or the life of an individual with whom the particular individual does not

deal at arm's length) is insured, the fair market value of the property is determined for the purposes of subsection 104(4) as if the value of the policy were the policy's cash surrender value immediately before the death. Similarly, where property is deemed by section 128.1 to have been disposed of by a particular individual as a consequence of the particular individual becoming or ceasing to be resident in Canada and there is a life insurance policy under which the particular individual's life (or the life of an individual with whom the particular individual does not deal at arm's length) is insured, the fair market value of the property is determined for the purposes of section 128.1 as if the value of the policy were the policy's cash surrender value immediately before the particular individual became or ceased to be resident in Canada.

Subsection 70(5.3) is also amended so that it applies in determining the fair market value of any property (e.g., an interest in a trust or a partnership), not just shares.

Subsection 70(5.3) is further amended to remove references to former subsections 70(9.4) and (9.5), given that these subsections have been repealed.

These amendments apply to dispositions that occur after October 1, 1996.

ITA
70(9.1) and (9.3)

Subsections 70(9.1) and (9.3) of the Act permit farm property (including shares of, or interests in, family farm corporations and family farm partnerships) to be disposed of on a rollover basis from a spousal trust to the children of the settlor of the spousal trust.

Subsections 70(9.1) and (9.3) are amended to preserve the existing rollover. These amendments are strictly consequential to changes to the rules in subsection 73(1) that govern rollovers to spousal trusts.

These amendments apply to dispositions after 1999.

These amendments also reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act*.

Clause 33

Inter Vivos Transfers by Individuals

ITA
73(1) to (1.02)

Subsection 73(1) of the Act generally provides for a tax-free disposition of capital property where it is transferred by an individual to the individual's spouse or to a spousal trust (i.e., essentially a trust for the exclusive benefit of the spouse during the spouse's lifetime). For subsection 73(1) to apply, the transferor and transferee must both be resident in Canada (determined without reference to subsection 94(1) as it read before 2001) at the time of the transfer. Provision is made to elect out of the rollover rule, in which case the proceeds of disposition for the transferor would be deemed by subsection 69(1) to be not less than the fair market value of the property transferred. Where there has been a transfer to a spousal trust, subsections 104(4) and 107(4) ensure that capital gains are appropriately recognized by a deemed disposition of trust property at the time of the beneficiary spouse's death (or, where applicable, at the time of any earlier distribution to another beneficiary).

Subsection 73(1) is amended, in conjunction with the introduction of subsection 73(1.01), so that the current rules in subsection 73(1) for transfers by an individual to a trust are extended to similarly allow for a tax-free disposition where:

- the individual transfers property to a trust for the exclusive benefit of the individual during the individual's own lifetime (such a trust will generally be an "*alter ego* trust", as defined in subsection 248(1), in the event that the individual is at least 65 years of age), or

- the individual transfers the property for the joint benefit of the individual and the individual's spouse during their lifetimes (such a trust will generally be a "joint partner trust", as defined in subsection 248(1), in the event that the individual is at least 65 years of age). This can involve either equal or unequal entitlements of the two spouses to trust income (as defined in subsection 108(3)).

However, new subsection 73(1.02) limits the application of subsection 73(1.01). It provides that, in order for subparagraphs 73(1.01)(*c*)(ii) and (iii) to apply to a transfer of property by an individual to a trust, the following conditions must be met:

- the trust was created after 1999;

- the individual has attained 65 years of age at the time the trust was created, except where no person (other than the individual) or partnership has any absolute or contingent right as a beneficiary under the trust (determined with reference to subsection 104(1.1));

- subject to the same exception, the transfer was not part of a series of transactions or events that includes a transfer of property to the transferor (or the spouse or former spouse of the transferor) from a trust (other than a testamentary trust) in circumstances to which subsection 107(2) applied, where one of the main purposes of that series can reasonably be considered to be to avoid the deemed disposition of trust property under subsection 104(4) or (5) on a day determined under paragraph 104(4)(*b*) or (*c*); and

- in the case of a trust to which the individual transfers property for the exclusive benefit of the individual during the individual's own lifetime, the trust does not make an election under subparagraph 104(4)(*a*)(ii.1). For more information on this election see the commentary below on amended paragraph 104(4)(*a*).

The purpose of the "age 65" condition (above and in amended subsection 104(4)) is to limit the opportunity to engage in tax planning involving trusts and the maximization of the deferral of the recognition of capital gains. For example, a 66 year old parent might arrange for common shares of a private corporation to be issued to his or her 27 year old child with the understanding that those common shares be transferred by the child into a trust effectively controlled by the parent that provides for beneficiaries after the child's death. The purpose of this arrangement may, in part, be to minimize capital gains otherwise recognized on the death of the parent. In these circumstances, the transfer by the child to the trust cannot be made on a rollover basis and subsection 104(4) generally provides for a deemed disposition on the 21st anniversary of the trust (rather than on the child's death).

The purpose of the third condition is consistent with the purpose of the "age 65" condition. Assume there is an upcoming 21-year anniversary for a trust the beneficiaries of which are a 66 year old parent and the adult children of the parent. Property is transferred to the parent alone (rather than to both the parent and the beneficiaries) on the understanding that the parent will transfer the property back to a trust with the same beneficiaries. In the absence of the third condition, the transactions described would result in an inappropriate extension of the 21-year rule for deemed dispositions of trust property.

Changes to subsections 104(4) and (6) and 107(4), as described in the commentary below, have been made so that the income tax regime for trusts to which transfers have been made under amended section 73 parallels the existing rules for spousal trusts.

These amendments apply to transfers that occur after 1999.

These amendments also reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act*.

ITA
73(1.1)

Subsection 73(1.1) of the Act generally provides that one individual is considered to have transferred property to another individual where the other individual obtains the property under provincial law or because of a decree, order or judgment of a competent tribunal made in accordance with that law. The rule applies for the purpose of the rollover rule in subsection 73(1).

Subsection 73(1.1) is amended to change a number of cross-references, to reflect amended subsection 73(1) and new subsection 73(1.01) (described in the commentary above).

This amendment applies to transfers that occur after 1999.

Clause 34

Attribution Rules

ITA
74.2(3) and (4)

Section 74.2 of the Act attributes to an individual taxable capital gains and allowable capital losses realized by the individual's spouse on the disposition of property that was loaned or transferred by the individual to or for the benefit of the individual's spouse, or someone who has since become the individual's spouse.

If the individual's spouse emigrates from Canada after having received the property, an accrued gain or loss on the property that is deemed to be realized by the spouse under paragraph 128.1(4)(*b*) of the Act could be attributed to the individual, resulting in anomalies in the application of the post-emigration loss rules under subsection 128.1(8) of the Act and the security rules under subsection 220(4.5) of the Act. To prevent such anomalies, new subsection 74.2(3) of the Act provides that the attribution rule in subsection 74.2(1) does not apply to the deemed disposition under paragraph 128.1(4)(*b*) unless the individual and the individual's spouse jointly elect, in their tax returns for the taxation year during which the spouse disposes of the property for the first time after emigration, that the rule apply to the deemed disposition.

New subsection 74.2(4) of the Act allows any assessment of tax to be made that is necessary for the joint election to be taken into account, but provides that no such assessment shall affect the computation of interest or penalties payable.

New subsections 74.2(3) and (4) apply after October 1, 1996.

Clause 35

Trusts

ITA
75(2)

Subsection 75(2) of the Act generally provides for the attribution of income from a trust property to a person resident in Canada where that property was received by the trust from the person and can revert to the person (or pass to other persons determined by that person).

Subsection 75(2) is amended to clarify that the reference to "person" in the provision includes a corporation.

This amendment applies to taxation years that begin after 2000.

ITA
75(3)(*a*) and (*b*)

Subsection 75(3) of the Act exempts certain trusts from the application of subsection 75(2), which generally provides for the attribution of income from a trust property to a person resident in Canada where that property was received by the trust from the person and can revert to the person (or pass to other persons determined by that person).

Paragraph 75(3)(*a*) is amended to extend the exemption to trusts governed by retirement compensation arrangements (as defined in subsection 248(1)). These trusts are subject to tax in the hands of the trustee under Part XI.3. This amendment ensures that these trusts will not also be subject to tax under Part I in the hands of a person (typically an employer) who made contributions to the trust. This amendment applies to taxation years ending after October 8, 1986, the date on which the retirement compensation arrangement rules were originally announced.

Paragraph 75(3)(*b*) is amended to extend the exemption to a trust described in paragraph (*a*.1) of the definition "trust" in subsection 108(1). For additional information on new paragraph (*a*.1) of the definition "trust", see the commentary on that provision. This amendment applies to the 1999 and subsequent taxation years.

Clause 37

Share for Share Exchange

ITA
85.1

The second and third paragraphs of the note on section 85.1 are replaced by the following:

Subsection 85.1(2) of the Act is amended to add new paragraph (*e*), consequential on the introduction of new subsection 85.1(5). New paragraph 85.1(2)(*e*) provides that subsection 85.1(1) will not apply to allow a tax-deferred rollover in respect of a Canadian share-for-share exchange where a vendor is a foreign affiliate and the vendor includes any portion of the gain or loss realized from the exchange in computing its foreign accrual property income for the year.

New subsection 85.1(5) of the Act provides a similar tax-deferred rollover for shareholders who exchange shares of a foreign corporation for shares of another foreign corporation to that provided in subsection 85.1(1) in respect of exchanges of shares of Canadian corporations. The application of subsection 85.1(5) is subject to the rollover for foreign shares contained in subsection 85.1(3) and 95(2) of the Act.

New subsection 85.1(6) of the Act describes the circumstances where new subsection 85.1(5) will not apply to a foreign share-for-share exchange. The rules in subsection 85.1(6) are similar to those in subsection 85.1(2), except that paragraph 85.1(6)(*e*) provides that subsection 85.1(5) will not apply where the vendor is a foreign affiliate and the exchanged foreign shares are excluded property (within the meaning assigned by subsection 95(1) of the Act) of the vendor. In other words, excluded property is not eligible for the foreign share-for-foreign share rollover in new subsection 85.1(5).

New subsections 85.1(2), (5) and (6) apply to foreign share-for-share exchanges that occur after 1995. Taxpayers may request a reassessment of their 1996, 1997 and 1998 taxation years in cases where they have disposed of shares in the relevant year in circumstances in which subsections 85.1(5) and (6) of the Act may

apply to the disposition. These requests should be made in writing to the Canada Customs and Revenue Agency Tax Centre which serves the area in which the taxpayer lives.

Clause 44

Shares Held by a Partnership

ITA
93.1(1)

New subsection 93.1(1) of the Act applies for the purpose of determining whether a non-resident corporation is a foreign affiliate of a corporation resident in Canada for the purposes of new subsection 93.1(2), subsection 20(12), sections 93 and 113 and any regulations made for the purposes of those sections and the rules in section 95 that are required to be applied to a foreign affiliate of a corporation resident in Canada in applying sections 93 and 113 of the Act and section 126.

For this purpose, new subsection 93.1(1) deems a member of a partnership to own its proportionate number of shares of a corporation held by a partnership. The number of shares owned by a member at any particular time is equal to the proportion of the total number of shares owned by the partnership that the fair market value of the member's interest in the partnership at that time is of the fair market value of all members' interests in the partnership at that time.

Subsection 93.1(1) applies at any time after November 30, 1999 in determining whether a non-resident corporation is a foreign affiliate of a taxpayer and, where the taxpayer elects in writing and files the election with Minister before 2002, the subsection also applies after 1972 and before December 1999 in determining whether a non-resident corporation is a foreign affiliate of a taxpayer (other than for the purposes of subsection 20(12) and section 126 of the Act).

Where Dividends Received by a Partnership

ITA
93.1(2)

New subsection 93.1(2) of the Act applies where a partnership receives a dividend from a foreign affiliate of the corporation resident in Canada.

Paragraph 93.1(2)(*a*) provides that, for the purposes of sections 93 and 113 of the Act and any regulations made for the purposes of those sections, a member of a partnership is treated as having received its proportionate share of a dividend received by the partnership from a foreign affiliate of the member. That proportionate share is determined as that proportion of the partnership dividend that the fair market value of the member's interest in the partnership is of the fair market value of all members' interests in the partnership.

Paragraph 93.1(2)(*b*) provides that, for the purposes of sections 93 and 113 and any regulations made for the purposes of those sections, a dividend that is treated as having been received by a member of a partnership under paragraph 93.1(2)(*a*) is treated as having been received in equal proportions on each affiliate share held by the partnership at that time.

Paragraph 93.1(2)(*c*) provides that, for the purpose of section 113, each affiliate share referred to in paragraph 93.1(2)(*b*) is treated as having been owned by each member of the partnership.

Subparagraph 93.1(2)(*d*)(i) provides that, notwithstanding paragraphs 93.1(2)(*a*), (*b*) and (*c*), where a member of the partnership is a corporation resident in Canada, the maximum amount that the member may deduct under section 113 is restricted to the amount of the dividend received by the partnership that is included in its income under subsection 96(1) of the Act.

Subparagraph 93.1(2)(*d*)(ii) provides that, notwithstanding paragraphs 93.1(2)(*a*), (*b*) and (*c*), where the member is another foreign affiliate of the corporation resident in Canada, the amount included in the other affiliate's income in respect of the dividend referred to in paragraph 93.1(2)(*a*) shall not exceed the amount that would have

been included in the other affiliate's income under subsection 96(1) if the value of H in the formula in the definition "foreign accrual property income" in subsection 95(1) were nil and the Act were read without reference to subsection 93.1(2). In effect, the maximum amount that an affiliate can deduct in computing its foreign accrual property income in respect of the dividend referred to in paragraph 93.1(2)(*a*) is restricted to the amount of the dividend included in the affiliate's foreign accrual property income under subsection 96(1).

New subsection 93.1(2) applies to dividends received after November 30, 1999.

Clause 45

Application of Certain Provisions to Trusts Not Resident in Canada

ITA
94(1)(*c*)(i)

Where certain conditions are met, a non-resident discretionary trust to which existing section 94 of the Act applies is generally treated as a trust resident in Canada for the purposes of Part I and sections 233.3 and 233.4 of the Act. Under existing subparagraph 94(1)(*c*)(i), the taxable income of such a trust is the total of its taxable income earned in Canada (computed on the assumption that the trust is non-resident) and two additional amounts. The first additional amount for a taxation year is described in clause 94(1)(*c*)(i)(B) as the amount that would be the trust's foreign accrual property income for the year if paragraph 94(1)(*d*) applied. Under clause 94(1)(*c*)(i)(C), the second additional amount for a taxation year is the net amount included under section 91 in computing the trust's income for the year.

Clause 94(1)(*c*)(i)(B) is amended so that the amount determined under that clause in respect of a trust for a taxation year is generally the trust's foreign accrual property income for the year, determined on the assumptions that the trust is a non-resident corporation and that all of the shares of the capital stock of that corporation are owned by a person resident in Canada. Exceptions to this general rule are described below.

Clause 94(1)(*c*)(i)(B) is also amended to clarify that the 21-year deemed disposition rule for trusts applies for the purpose of computing the amount determined under clause 94(1)(*c*)(i)(B), notwithstanding the fact that the rule applies to trusts and not to corporations. This clarification applies to disposition dates determined after 1998.

Subclauses 94(1)(*c*)(i)(B)(II) and (III) are introduced so that, after 1998, dividends from foreign affiliates, and taxable capital gains and allowable losses that relate to "excluded property" (as defined in subsection 95(1)), are included in the trust's foreign accrual property income determined under clause 94(1)(*c*)(i)(B). Because trust income can be distributed as trust capital, it is appropriate to remove the exclusions from foreign accrual property income for dividends and capital gains from excluded property.

Subclause 94(1)(*c*)(i)(B)(IV) is introduced so that section 94.1 is no longer relevant for the purposes of determining the amount under clause 94(1)(*c*)(i)(B). Instead, new clause 94(1)(*c*)(i)(D) adds the amount determined under that section in respect of a trust in computing the trust's taxable income under subparagraph 94(1)(*c*)(i).

Clause 94(1)(*c*)(i)(C) is amended to clarify that the second additional amount added in computing a trust's taxable income under paragraph 94(1)(*c*) is determined by subtracting the amounts deducted in computing income under subsections 91(2), (4) and (5) from the amount added in computing income under subsections 91(1) and (3). This amendment applies to the 1999 and subsequent taxation years.

Clause 94(1)(*c*)(i)(E) (in conjunction with a change to the opening words of subparagraph 94(1)(*c*)(i)) is introduced to provide for a deduction in computing the taxable income for a taxation year of a trust under subparagraph 94(1)(*c*)(i). This deduction is equal to the amount, if any, by which the total of the amounts deducted under subsections 91(2), (4) and (5) in computing the trust's income for the year exceeds the total amount included in computing the trust's income for the year because of subsections 91(1) and (3). Clause 94(1)(*c*)(i)(E) will apply, for example, where an amount was included in computing a trust's taxable income because of clause 94(1)(*c*)(i)(C) and there is subsequently a distribution of dividends to which that amount relates. Clause 94(1)(*c*)(i)(E) is meant to avoid the double

taxation of the same income that might otherwise arise. The example below illustrates the operation of clause 94(1)(*c*)(i)(E).

EXAMPLE

Trust X is a non-resident trust to which paragraph 94(1)(c) applies. Trust X owns 100% of the shares in Foreignco. In year 1, Foreignco's only income is $20,000 of interest income on government bonds. In year 2, Foreignco pays a dividend of $7,000 to Trust X. In year 3, Foreignco pays a dividend of $15,000 to Trust X. Foreignco had no other relevant income in years 2 and 3.

Results:

1. The taxable income of Trust X for year 1 is calculated under subparagraph 94(1)(c)(i) as follows:

- *ADD the amount that would be Trust X's "foreign accrual property income" if a number of assumptions were made. Trust X's own foreign accrual property income for year 1 is nil.*[2]

- *ADD the net amount required by section 91 to be included in Trust X's income. This amount is $20,000.*[3]

As a result, the taxable income of Trust X for year 1 is $20,000.

2. The taxable income of Trust X for year 2 is calculated as follows:

- *ADD the amount that would be Trust X's "foreign accrual property income" if a number of assumptions were made. Because of subclause 94(1)(c)(i)(B)(II), dividends received by affiliates are included in computing Trust X's foreign accrual property income for this purpose. Consequently, Trust X's "foreign accrual property income" is $7,000.*

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[2] Clause 94(1)(*c*)(i)(B), in conjunction with definition of "foreign accrual property income" in subsection 95(1).

[3] Clause 94(1)(*c*)(i)(C), in conjunction with subsection 91(1).

- *SUBTRACT the net amount deducted under section 91 in computing the trust's income.*[4] *The deduction available is equal to the lesser of the amount of the dividend ($7,000) and the net adjusted cost base adjustments ($20,000) up to the time the $10,000 dividend is paid.*[5] *Consequently, the full $7,000 is deducted because of clause 94(1)(c)(i)(E).*

As a result, the taxable income of Trust X for year 2 is nil.

3. The taxable income of Trust X for year 3 is calculated as follows:

- *ADD the amount that would be Trust X's "foreign accrual property income" if a number of assumptions were made. Because of subclause 94(1)(c)(i)(B)(II), dividends received by affiliates are included in computing Trust X's foreign accrual property income for this purpose. Consequently, Trust X's "foreign accrual property income" is $15,000.*

- *SUBTRACT the net amount deducted under section 91 in computing the trust's income.*[6] *The deduction available is equal to the lesser of the amount of the dividend ($15,000) and the net adjusted cost base adjustments ($20,000-$7,000) up to the time the $15,000 dividend is paid.*[7] *Consequently, $13,000 is deducted because of clause 94(1)(c)(i)(E).*

  As a result, the taxable income of Trust X for year 2 is $2,000.

These amendments come into effect in the manner indicated in the commentary above and apply to the 1999 and subsequent taxation years. However, as announced in the 1999 budget, further amendments to this section are contemplated.

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[4] Clause 94(1)(*c*)(i)(E).

[5] Subsection 91(5).

[6] Clause 94(1)(*c*)(i)(E).

[7] Subsection 91(5).

ITA
94(1)(*c*)(ii)

Subparagraph 94(1)(*c*)(ii) of the Act is relevant for the purpose of determining the foreign tax credit of a trust to which paragraph 94(1)(*c*) applies. For this purpose, the trust's income is generally deemed to be from sources in the country in which the trust would be resident if that paragraph did not apply. However, subparagraph 94(1)(*c*)(ii) does not apply in connection with taxable income calculated under clause 94(1)(*c*)(i)(A) (taxable income earned in Canada).

Subparagraph 94(1)(*c*)(ii) is amended strictly to reflect the amendments to subparagraph 94(1)(*c*)(i). Under amended subparagraph 94(1)(*c*)(ii), the portion of the taxable income sourced for the purposes of the foreign tax credit is equal to amount that would be the trust's taxable income calculated under subparagraph 94(1)(*c*)(i) if the trust's taxable income earned in Canada were not taken into account.

This amendment applies to the 1999 and subsequent taxation years. However, as announced in the 1999 budget, further amendments to section 94 are contemplated.

Clause 48

Trusts and Their Beneficiaries

ITA
104(1) and (1.1)

Subsection 104(1) of the Act provides a rule under which a reference to a trust or estate is read in the Act as a reference to the trustee or the executor, administrator, heir or other legal representative having ownership or control over trust property.

Subsection 104(1) is amended to include a "liquidator of the succession" to the list of persons to which a trust or estate refers for the purposes of the Act. This amendment is made to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.

Subsection 104(1) is amended so that this rule does not apply where the context otherwise requires and to clarify that this rule is merely meant to be a convenient way of linking the trustees and others described in the subsection with a trust for the purposes of the Act. This amendment recognizes that there are references to "trust" in the Act that are meant to indicate a trust arrangement, rather than the persons who are responsible for the operation of the arrangement. The latter references include those found in subsections 74.4(4), 104(5.3) and (5.5), 108(6) and 127(7).

Subsection 104(1) is amended, in conjunction with 104(1.1), so that, except for the purposes of those two subsections and paragraph (*k*) of the definition "disposition" in subsection 248(1), references in the Act to trusts are not considered to include an arrangement where a trust can reasonably be considered to act as agent for its beneficiaries with respect to all dealings in all of the trust's property. These arrangements are generally known as "bare trusts". Trusts described in paragraphs (*a*) to (*e*.1) of the definition "trust" in subsection 108(1) are expressly not affected by this amendment.

New subsection 104(1.1) applies for the purpose of identifying beneficiaries under a trust for the purpose of subsection 104(1), as well as for the purposes of subparagraph 73(1.02)(*b*)(ii) and paragraph 107.4(1)(*e*). A person or partnership is deemed not to be a beneficiary under a trust at a particular time for these purposes where the person or partnership is beneficially interested in the trust at the particular time solely because of any one, or a combination of, the following:

- a right that may arise as a consequence of the terms of the will or other testamentary instrument of an individual who, at the particular time, is a beneficiary under the trust;

- a right that may arise as a consequence of the law governing the intestacy of an individual;

- a right as a shareholder under the terms of the shares of the capital stock of a corporation that, at the particular time, is a beneficiary under the trust; or

- a right as a member of a partnership under the terms of the partnership agreement, where, at the particular time, the partnership is a beneficiary under the trust.

These amendments generally apply to the 1998 and subsequent taxation years. However, in order to co-ordinate this amendment with changes to the replacement of the definition "disposition" in section 54 with the new definition of the same expression in subsection 248(1), it does not apply in connection with transfers of property that occurred before December 24, 1998.

ITA
104(4) to (5.2)

Subsections 104(4) to (5.2) of the Act set out what is generally referred to as the "21-year deemed realization rule" for trusts. The purpose of the rule is to prevent the use of trusts to defer indefinitely the recognition for tax purposes of gains accruing on capital properties, resource properties and land inventories. These subsections generally treat such properties as having been disposed of and reacquired by trusts (other than spousal trusts) every 21 years at the properties' fair market value. The first deemed disposition day for post-1971 spousal trusts, as provided under paragraph 104(4)(*a*), is the day on which the spouse beneficiary dies. The fair market value of property that is deemed to be disposed of on a day determined under paragraph 104(4)(*a*) or (*a*.1), is determined with reference to the valuation rule for insurance policies in amended subsection 70(5.3) (see the commentary above on that provision).

Subsections 104(4) to (5.2) are amended so that the deemed realization rules do not apply to "exempt property" of a non-resident trust, as the expression is now defined in subsection 108(1). "Exempt property" is defined as property the income or gain from the disposition of which by a taxpayer is exempt from Canadian taxation for the taxpayer either because the taxpayer is not resident in Canada or because of a tax treaty. The purpose of this amendment is to prevent the deemed realization rules from being used to increase the cost of such property. The increased cost might be relevant in the event that a non-resident trust distributes such property to Canadian beneficiaries. These amendments apply to deemed disposition days that are after December 23, 1998. In the case of capital property (other than depreciable property), the amendments also apply to

deemed disposition days that are after 1992, but only for the purpose of determining after December 23, 1998 the cost amount to a trust of property.

Paragraph 104(4)(*a*) is amended to provide the first deemed disposition day in respect of an *inter vivos* trust created after 1999 that at any time after 1999 was a trust for the exclusive benefit of the settlor during the settlor's lifetime (i.e., an "*alter ego* trust", as newly defined in subsection 248(1)) or a trust for the joint benefit of the settlor and the settlor's spouse during their lifetimes (i.e., a "joint partner trust", as newly defined in subsection 248(1)). The first deemed disposition date in these circumstances, in the event that the settlor was at least 65 years of age at the time of the settlement, is generally the day on which the settlor dies (or, in the case of a trust for the joint benefit of the settlor and spouse, the day on which the survivor dies). However, where a trust that would otherwise be an *alter ego* trust so elects under subparagraph 104(4)(*a*)(ii.1), the first deemed disposition date of the trust will generally be the 21st anniversary of the creation of the trust, as determined under paragraph 104(4)(*b*). This amendment applies to the 2000 and subsequent taxation years. For an explanation of the age 65 restriction, see the commentary on new subsection 73(1.02).

Paragraph 104(4)(*a*.2) is introduced to provide for a deemed disposition day for a trust that distributes property financed by a liability of the trust. This measure only applies, however, if one of the purposes of the transaction was to avoid taxes otherwise payable as a consequence of the death of an individual. The deemed disposition under this paragraph occurs immediately after the distribution of the property (as the determination is made as if a day had ended immediately after each distribution). This amendment applies to deemed disposition days determined after December 17, 1999.

Paragraph 104(4)(*a*.3) is introduced to provide for a deemed disposition day for a trust in the event that an individual, after December 17, 1999, has transferred property to the trust in circumstances to which subsection 73(1) applies, it is reasonable to conclude that the property was so transferred in anticipation that the taxpayer would subsequently cease to reside in Canada and the individual subsequently ceases to reside in Canada. This measure does not apply, however, to property transferred that is exempt under

amended subparagraphs 128.1(4)(*b*)(i) to (iii) from a deemed disposition on the transferor's emigration. The deemed disposition under paragraph 104(4)(*a*.3) occurs immediately after the individual ceases to be resident in Canada.

Paragraph 104(4)(*c*) is amended so that there is not a deemed disposition day for a trust 21 years after any day determined under new paragraph 104(4)(*a*.2) or (*a*.3). This amendment applies to the 2000 and subsequent taxation years.

These amendments also reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act.*

ITA
104(5.8)

Subsection 104(5.8) of the Act is a special rule designed to prevent the avoidance of the 21-year rule through the use of trust-to-trust transfers that do not involve dispositions of property at fair market value. Subsection 104(5.8) generally provides for a transferee trust to assume the next deemed disposition day of the transferor, if that day is earlier than the transferee's next deemed disposition day. In the case of spousal trusts under which the beneficiary spouse is still alive, subsection 104(5.8) provides a deemed disposition as soon as the transfer is completed unless relief is provided under paragraph 104(5.8)(*b*). Paragraph 104(5.8)(*b*) provides relief where both the transferor and transferee trusts are spousal trusts to which paragraph 104(4)(*a*) or (*a*.1) applies and under which the spouse beneficiary is alive.

Subsection 104(5.8) is amended to eliminate a reference to trust transfers under paragraph (*e*) of the definition "disposition" in section 54, as a consequence of the repeal of that definition. Subsection 104(5.8) is also amended so that it now covers transfers under new paragraph (*f*) of the definition "disposition" in subsection 248(1) and under new subsection 107.4(3). These amendments apply to transfers made after December 23, 1998.

Subsection 104(5.8) is amended so that it does not apply to transfers between trusts, if the transferee trust was, at the time of the transfer, described in paragraph (*g*) of the definition "trust" in subsection 108(1). This amendment, which is made as a consequence of the

introduction of subparagraph (*g*)(iv) of that definition, applies only to transfers made after February 11, 1991 and before December 24, 1998. Subparagraph (*g*)(iv) of that definition has the effect of limiting an exemption from the 21-year deemed disposition rule for a trust in which interests are vested indefeasibly, in the event that non-resident beneficiaries own more than 20% of the interests in the trust.

Subparagraph 104(5.8)(*a*)(i) is amended to ensure that the determination of a deemed disposition day for a transferee trust will not preclude any earlier deemed disposition day under new paragraph 104(4)(*a*.2) or (*a*.3). This amendment applies to transfers made after December 17, 1999.

Subsection 104(5.8) is further amended to extend its existing rules for transfers from spousal trusts to transfers from other specified trusts. The additional trusts so specified are those created after 1999 by a settlor (aged 65 years or more) for the exclusive benefit of the settlor during the settlor's lifetime (i.e., an "*alter ego* trust", as newly defined in subsection 248(1)) or for the joint benefit of the settlor and the settlor's spouse during their joint lifetimes (i.e., a "joint partner trust", as newly defined in subsection 248(1)). Where the settlor of an *alter ego* trust is still alive (or, in the case of a joint partner trust, where the settlor or the spouse is still alive), a deemed disposition day for the trust may occur once a transfer from the trust is completed. However, amended paragraph 104(5.8)(*b*) and new paragraphs 104(5.8)(*b*.1) and (*b*.2) provide for no deemed disposition day in the case of a transfer from one of the additional specified trusts where the transferee trust is also a specified trust to which paragraph 104(4)(*a*) applies and the settlor (or, in the case of a joint partner trust, either the settlor or that spouse) is alive. These amendments apply to transfers made after 1999. For further detail on new rules for *alter ego* trusts and joint partner trusts, see the commentary on amended subsection 73(1) and paragraph 104(4)(*a*).

These amendments also reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act.*

ITA
104(6)

Subsection 104(6) of the Act generally allows a trust to deduct an amount for a taxation year not exceeding its income for the year that became payable to its beneficiaries. However, in the case of spousal trusts there are restrictions designed to ensure that a spousal trust cannot claim a deduction under subsection 104(6) in respect of income allocated to non-spouse beneficiaries to the extent the income accrues during the lifetime of the spouse beneficiary. (With regard to income for the year in which a spouse beneficiary dies, this restriction only applies in connection with income from dispositions of capital property, land inventory and Canadian and foreign resource property that occur before the end of the deemed disposition day caused by the spouse's death.) There is also a restriction in subsection 104(6) designed to limit the extent to which a trust can claim a deduction in respect of distributions by the trust of amounts paid to the trust from the trust's NISA Fund No. 2 (as defined in subsection 248(1)).

Paragraph 104(6)(*a*.3) is introduced so that the restrictions with regard to a trust's NISA Fund No. 2 do not apply to any trust deemed to exist because of the special rules for communal organizations in section 143. This amendment applies to the 1998 and subsequent taxation years.

Paragraph 104(6)(*b*) is amended to extend the restrictions for spousal trusts to other specified trusts created after 1999. The trusts so specified are those created after 1999 by a settlor (aged 65 years or more) for the exclusive benefit of the settlor during the settlor's lifetime (i.e., an "*alter ego* trust", as newly defined in subsection 248(1)) or for the joint benefit of the settlor and the settlor's spouse during their joint lifetimes (i.e., a "joint partner trust", as newly defined in subsection 248(1)). The restrictions for *alter ego* trusts apply until the death of the settlor. The restrictions for joint partner trusts apply until the later of the death of the settlor and the death of the spouse. For further detail on new rules for these specified trusts, see the commentary on amended subsection 73(1) and paragraph 104(4)(*a*). This amendment applies to the 2000 and subsequent taxation years.

Clauses 104(6)(*b*)(ii)(A) and (B) are amended to refer to a post-1971 partner trust, strictly as a consequence of the new definition of this term contained in subsection 248(1). For further detail, see the commentary on amended subsection 248(1). This amendment applies to the 2000 and subsequent taxation years.

Subparagraph 104(6)(*b*)(iii) is amended to extend the restrictions for deductions under subsection 104(6) in the taxation year in which the relevant beneficiary dies. The intended effect of the new restrictions is that post-1971 partner trusts, *alter ego* trusts and joint partner trusts cannot deduct an amount under subsection 104(6) in respect of income accrued up to the end of the deemed disposition day caused by the death of the spouse or other relevant beneficiary. This amendment applies to the 2000 and subsequent taxation years.

These amendments also reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act.*

EXAMPLE

The spouse beneficiary of a post-1971 partner trust dies in the 2001 taxation year of the trust. Before distribution to beneficiaries, the trust's total income for the year (determined without reference to any deemed disposition under subsection 104(4) and any deduction under subsection 104(6)) is $100, of which $20 is payable to the spouse prior to the spouse's death and of which the remaining $80 is payable to the surviving beneficiaries. $40 of the $100 income accrued before the spouse's death.

Results:

1. Under subparagraph 104(6)(b)(i) the trust's income for the year that became payable in the year to beneficiaries is $100.

2. The amount determined under subparagraph 104(6)(b)(iii) is $20 (i.e., [$100 - ($20 + $60)]).

3. The total amount deductible by the trust cannot exceed the amount by which the amount determined under subparagraph 104(6)(b)(i) exceeds the amount determined under subparagraph 104(6)(b)(iii).

4. Consequently, the trust's maximum deduction for the year is $80 (i.e., $100 - $20). The trust is not allowed a deduction in respect of the $20 portion of trust income accrued to the end of the deemed disposition day caused by the spouse's death but payable only after the death.

ITA
104(15)

Subsection 104(14) of the Act provides a mechanism under which a preferred beneficiary of a trust and the trust can elect to have a designated amount taxed in the hands of the beneficiary rather than at the trust level. Under the definition "preferred beneficiary" in subsection 108(1), a preferred beneficiary of a trust is generally a disabled person resident in Canada who is, or is closely related to, the settlor of the trust. Under paragraph 104(15)(*a*), if the preferred beneficiary is the living spouse beneficiary under a spousal trust, an "allocable amount" in respect of the beneficiary for a taxation year is the trust's "accumulating income" for the year (which, in general terms, is defined in subsection 108(1) as undistributed trust income).

Subsection 104(15) is amended so that the preferred beneficiary election in connection with allocations of income from an *alter ego* trust, a joint partner trust, a post-1971 partner trust or a trust described in the definition "pre-1972 spousal trust" in subsection 108(1) is available to the spouse or other beneficiary (i.e., the settlor) identified in paragraph 104(4)(*a*), only while the spouse or the other beneficiary is alive.

This amendment applies to the 2000 and subsequent taxation years.

This amendment also reflects changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act.*

ITA
104(19)

Subsection 104(19) of the Act permits a trust to designate dividends received by it in a taxation year on shares of a taxable Canadian corporation to be taxable dividends received by a beneficiary of the trust, rather than by the trust itself, in the year from the corporation.

Subsection 104(19) of the Act is amended so that a trust will, except for the purposes of the dividend gross-up in paragraph 82(1)(*b*) and stop-loss rules in paragraphs 107(1)(*c*) and (*d*) and section 112, still be treated as having received the dividend even if it is designated in favour of a beneficiary. In most cases, the trust will be allowed a corresponding deduction under subsection 104(6) to offset the resulting income inclusion. However, as described in the commentary on amendments to subsection 104(6), there are certain restrictions under amended subsection 104(6) on the deduction of amounts made payable from *alter ego* trusts, joint partner trusts and post-1971 partner trusts.

This amendment applies to taxation years that end after 2000.

Clause 49

Disposition by Taxpayer of Income Interest

ITA
106(2)

Subsection 106(2) of the Act applies where a taxpayer disposes of an income interest (as defined in subsection 108(1)) in a trust. Paragraph 106(2)(*a*) provides that unless the disposition results from a distribution of property by the trust, the taxpayer's proceeds of disposition are included in computing the taxpayer's income for the year that includes the disposition.

Paragraph 106(2)(*a*) is amended to ensure that where a taxpayer disposes of an income interest in a trust that includes a right to enforce payment by the trust, the proceeds of disposition of the income interest are offset by the amount that has been included in the taxpayer's income under subsection 104(13) because of that right. This measure is meant to ensure that there is no double taxation where such rights are disposed of.

This amendment applies to the 2000 and subsequent taxation years.

Clause 50

Capital Interest in a Trust

ITA
107(1)(*a*) and (*b*)

Subsection 107(1) of the Act contains special rules that apply to the disposition of a capital interest in a trust.

Paragraph 107(1)(*a*) applies for the purpose of computing a taxpayer's taxable capital gain from the disposition of a capital interest in a personal trust (or a prescribed trust described in section 4800.1 of the Regulations), except where the interest was an interest in a non-resident *inter vivos* trust purchased by the taxpayer and the disposition was not by way of a distribution to which subsection 107(2) applies. For this purpose the residency of the trust is to be determined without reference to section 94 as it read before 2001.

Where paragraph 107(1)(*a*) applies, the adjusted cost base (ACB) to the taxpayer of a trust capital interest for capital gains purposes is generally equal to the greater of the ACB otherwise determined and the "cost amount" of the interest. Subsection 108(1) provides that, for this purpose, the "cost amount" of a capital interest at any time is based on the amount of the trust's money and the cost amount of the trust's other property. The "cost amount" mechanism in paragraph 107(1)(*a*) generally allows the flow-out from a personal or prescribed trust to a beneficiary of trust capital without adverse tax consequences. However, the concluding words in subsection 107(1) provide that paragraph 107(1)(*a*) generally does not apply with regard to certain purchased interests in non-resident trusts.

Paragraph 107(1)(*a*) is amended, in conjunction with the repeal of the concluding wording in subsection 107(1), to ensure that paragraph 107(1)(*a*) never applies to dispositions of any capital interests in non-resident trusts acquired for consideration. New paragraph 108(6)(*c*) and new subsection 108(7) are relevant in determining where an interest in a trust has been acquired for consideration. Amended paragraph 107(1)(*a*) also provides that, for this purpose, a non-resident trust includes a trust deemed by subparagraph 94(1)(*c*)(i) to be resident in Canada.

Paragraph 107(1)(*b*) is repealed because it is unnecessary. Since paragraph 107(1)(*a*) applies only for the purposes of computing a taxpayer's capital gain, it is clear without paragraph 107(1)(*b*) that the ACB calculation in paragraph 107(1)(*a*) is not relevant for the purposes of computing a taxpayer's allowable capital loss.

These amendments apply to the 2000 and subsequent taxation years.

ITA
107(2), (2.001), (2.002) and (3)

The second paragraph of the note on these subsections is replaced by the following:

Subsection 107(2) is amended to clarify that it applies in connection with distributions in respect of a capital interest in a personal or prescribed trust only if the distribution results in a disposition of all or part of the capital interest. Where the distribution does not constitute a disposition of a capital interest in a trust because of new paragraph (*i*) of the definition "disposition" in subsection 248(1), the rules in amended subsection 107(2.1) apply.

ITA
107(2.01)

Subsection 107(2.01) of the Act allows a personal trust to elect to be treated as if it had disposed of, and reacquired, a principal residence at its fair market value immediately before distributing the property to one of its beneficiaries under subsection 107(2). The rule does not apply to distributions of property by a post-1971 partner trust in circumstances to which subsection 107(4) applies. (Subsection 107(4) generally applies to distributions made by such a trust to a beneficiary, other than the beneficiary spouse, before the death of the beneficiary spouse.) Subsection 107(2.01) is designed to allow a personal trust to take advantage of the principal residence exemption. In this regard, reference can be made to the definition of "principal residence" in section 54.

Subsection 107(2.01) is amended to eliminate the reference to subsection 107(4), given that subsection 107(2.1) now applies to distributions to which amended subsection 107(4) applies.

This amendment applies to distributions made after 1999.

ITA
107(2.1)

Where trust property is distributed by a trust to a beneficiary in satisfaction of the beneficiary's capital interest in the trust and subsection 107(2) of Act does not apply, the rules in subsection 107(2.1) apply. Subsection 107(2.1) also applies to a distribution by a trust in satisfaction of a right described in subsection 52(6). Under paragraphs 107(2.1)(*a*) to (*c*), the trust is deemed to have disposed of the distributed property for the property's fair market value and the beneficiary is deemed to have acquired the property, and disposed of the capital interest or right described in subsection 52(6), for the same amount. Notwithstanding the reference to subsection 52(6) (under which a cost is ascribed to the right to enforce payment out of a trust's capital gains and income), it is unclear that there is relief from double taxation on gains associated with the dispositions of the distributed property and the relinquished capital interest.

Subsection 107(2.1) is amended so that it no longer overrides every other provision of the Act. For example, subsection 107(2.1) no longer deems there to be a disposition of property where the existing law provides that there was no disposition because of paragraph (*e*) of the definition "disposition" in section 54. This amendment is consequential on the replacement of the existing definition "disposition" in section 54 with the new definition of the same expression in subsection 248(1) and new rules in section 107.4 to deal with acquisitions by trusts that do not involve any change in beneficial ownership.

Subsection 107(2.1) is amended so that it applies in connection with all distributions in respect of a capital interest in a trust, regardless of whether the distribution results in a disposition of all or part of the capital interest. This includes rights to which subsection 52(6) formerly applied, but which are now included as part of a capital interest in a trust under the amended definition of "capital interest" in subsection 108(1). Distributions in respect of amounts described in paragraph (*h*) and (*i*) of the definition "disposition" in subsection 248(1) need to be referred to in order to take into account the possibility that a distribution from a trust may consist only partly in respect of such amounts. In addition, even if a cash distribution is

solely in respect of such an amount, it may not necessarily be denominated in Canadian dollars, in which case the trust may recognize a foreign currency gain or loss on the distribution. However, under amended paragraph 107(2.1)(*c*), proceeds of disposition are only determined with regard to the portion of a capital interest in a trust that is disposed of because of a distribution from the trust. No proceeds of disposition are determined in respect of rights to amounts to which paragraph (*h*) and (*i*) of that definition apply.

The proceeds of disposition for the portion of a capital interest in a trust that is disposed of because of a distribution (other than a distribution to which paragraph 107(2.1)(*d*) applies) are determined under paragraph 107(2.1)(*c*) as follows:

- ADD the proceeds of disposition determined in respect of the distribution (other than any portion of those proceeds that is a payment to which paragraph (*h*) or (*i*) of the definition "disposition" in subsection 248(1) applies). Note: paragraph (*h*) or (*i*) of that definition apply to a payment that represents a distribution of income or capital gains or to a payment from a unit trust that does not cause a reduction of the number of issued units of the trust;

- where the property distributed is not Canadian resource property or foreign resource property, SUBTRACT the amount (if any) by which the fair market value of the property exceeds the cost amount of the property (however, disregard this excess to the extent it represents a payment to which paragraph (*h*) or (*i*) of that definition applies); and

- SUBTRACT the "eligible offset" in respect of the distribution, as defined in subsection 108(1). (This is essentially debt assumed by the beneficiary on the distribution.)

Where there is no disposition of a capital interest because of paragraph (*h*) or (*i*) of the definition "disposition" in subsection 248(1), an amount distributed from the trust to a beneficiary generally results in a reduction of the beneficiary's adjusted cost base of the capital interest pursuant to paragraph 53(2)(*h*).

Paragraph 107(2.1)(*d*) applies to distributions of property (other than taxable Canadian property or business property connected to a Canadian permanent establishment) from a non-resident trust unless subsection 75(2) would, if the Act were read without reference to that paragraph, result in the attribution to a taxpayer of an income, loss, taxable capital gain or allowable capital loss in respect of the distribution. In these circumstances, new paragraph 107(2.1)(*d*) deems the beneficiary to acquire the property at its fair market value and to dispose of the corresponding portion of the capital interest in the trust for proceeds equal to the fair market value of the property less the total of two amounts. The first amount represents the portion of the distribution that is a payment to which paragraph (*h*) or (*i*) of the definition "disposition" in subsection 248(1) applies (i.e., a payment that represents a distribution of income or capital gains, or a payment from a unit trust that does not cause a reduction of the number of issued units of the trust). The second amount is the "eligible offset" (as defined in subsection 108(1)) in respect of the distribution (i.e., essentially debt assumed by the beneficiary on the distribution). Paragraph 107(2.1)(*d*) also ensures that there are no tax consequences to the trust in respect of the distribution of the property.

These amendments apply to distributions made after 1999 (other than distributions before March 2000 in connection with rights described in subsection 52(6) of the Act that were acquired before 2000).

The examples below illustrate the operation of amended subsection 107(2.1). Except as indicated otherwise, it is assumed that the trusts referred to below are all resident in Canada.

EXAMPLE 1

In 2000, a commercial trust distributes non-depreciable capital property (shares) to its beneficiary resident in Canada in satisfaction of the beneficiary's capital interest in the trust. The adjusted cost base of the shares is $40. The adjusted cost base of the beneficiary's capital interest is $20. The fair market value of the property is $100.

Results:

1. Subsection 107(2.1) applies to the distribution.

2. The trust is deemed by paragraph 107(2.1)(a) to have disposed of the property for $100 proceeds, so there is a capital gain of $60 on the resulting disposition and a taxable capital gain of $45.

3. The beneficiary is deemed by paragraph 107(2)(b) to have acquired the property at a $100 cost.

4. Because the distribution gives rise to a capital gain, the amount of the capital gain ($60) reduces the proceeds of disposition of the beneficiary's capital interest under subparagraph 107(2.1)(c)(ii). The beneficiary is deemed to have disposed of the capital interest for $40 proceeds ($100 - $60). Alternatively, in the event that the payment of the gain were considered to be payment of the capital gains of the trust to which paragraph (i) of the definition "disposition" in subsection 248(1) applied, $40 would be determined under subparagraph 107(2.1)(c)(i) and no amount would be determined under subparagraph 107(2.1)(c)(ii). Consequently, under both of the alternative analyses, the beneficiary's proceeds of disposition of the beneficiary's capital interest in the trust are $40.

5. Consequently, the capital gain from the disposition of the capital interest is $20 ($40 - $20).

EXAMPLE 2

A personal trust distributes non-depreciable capital property (shares that are not taxable Canadian property) to its non-resident beneficiary in satisfaction of the beneficiary's capital interest in the trust. The adjusted cost base of the shares is $40. The adjusted cost base of the beneficiary's capital interest, determined before the application of paragraph 107(1)(a), is $0. The fair market value of the property is $100.

Results:

1. Subsection 107(2.1) applies to the distribution because of the application of amended subsection 107(5).

2. The trust is deemed by paragraph 107(2.1)(a) to have disposed of the property for $100 proceeds, so there is a capital gain of

$60 from the resulting disposition and a taxable capital gain of $45.

3. The beneficiary is deemed by paragraph 107(2.1)(b) to have acquired the property at a $100 cost.

4. Because the distribution gives rise to a capital gain, the amount of the capital gain ($60) reduces the proceeds of the beneficiary's capital interest under subparagraph 107(2.1)(c)(ii). The beneficiary is deemed to have disposed of the capital interest for $40 proceeds ($100 - $60). The alternative analysis in paragraph 4 of Example 1 would likewise result in deemed proceeds of $40.

5. The capital interest in the trust constitutes taxable Canadian property for the non-resident beneficiary. For the purposes of computing capital gains, the adjusted cost base of the capital interest under subsection 107(1) is $40, being the greater of its adjusted cost base (nil) determined before the application of that subsection and the cost amount ($40) to the trust of the distributed property. Consequently, the taxable capital gain from the disposition of the capital interest is nil.

6. The allowable capital loss from the disposition of the capital interest is also nil.

ITA
107(4)

Subsection 107(4) of the Act applies where a post-1971 partner trust distributes capital property, resource property or land to a beneficiary other than the beneficiary spouse. When this occurs while the beneficiary spouse is alive, there is generally a deemed disposition of the property at its fair market value.

Subsection 107(4) is amended so that similar rules apply to *alter ego* trusts and joint partner trusts, as newly defined in subsection 248(1). Subsection 107(4) will apply to a distribution by these trusts where the individual (or, in the case of a joint partner trust, either the individual or the spouse) is alive on the day of the distribution and the distribution is made to a beneficiary other than the individual (or, in the case of a joint partner trust, the individual or the spouse). For

more detail on these trusts, see the commentary on amended subsections 73(1) and 104(4).

Subsection 107(4) is amended so that the rules set out in amended subsection 107(2.1) apply to distributions covered by subsection 107(4).

These amendments apply to distributions made after 1999.

These amendments also reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act*.

ITA
107(5)

Subsection 107(5) of the Act applies to the distribution of property (other than taxable Canadian property, Canadian resource property and shares in non-resident-owned investment corporations), where the distribution would otherwise be made to a non-resident beneficiary on a rollover basis under subsection 107(2). With regard to such distributions, subsection 107(5) provides for a deemed disposition of the distributed property at its fair market value and an acquisition by the beneficiary for the same amount. In addition, paragraph 107(5)(*c*) provides for proceeds of disposition of the relinquished capital interest equal to the adjusted cost base of that interest.

Subsection 107(5) is amended to replace existing exemptions with regard to taxable Canadian property and Canadian resource property with exemptions for property described in any of new subparagraphs 128.1(4)(*b*)(i) to (iii). This amendment applies to distributions made after October 1, 1996. For further detail on the enumerated subparagraphs, see the commentary on amended subsection 128.1(4).

Subsection 107(5) is also amended so that it only applies with regard to distributions by trusts resident in Canada. This amendment applies to distributions made after October 1, 1996 and recognizes that, if a distribution of property is made from a non-resident trust to a non-resident beneficiary, Canada's authority to ultimately collect tax on a future disposition of the property has not been compromised because of the distribution. This amendment is consistent with the policy with regard to distributions before October 2, 1996, as the type of property deemed to be disposed of before that date under subsection

107(5) would not have resulted in a non-resident trust being subject to Canadian tax.

Subsection 107(5) is amended so that, where it applies, the amended rules in subsection 107(2.1) provide for the corresponding tax consequences. This amendment applies with regard to distributions made after 1999.

Clause 51

Distribution by Employee Trust, etc.

ITA
107.1

Section 107.1 of the Act provides rules to deal with a distribution to a taxpayer of a property by an employee trust or a trust governed by an employee benefit plan under which the taxpayer is a beneficiary. In the case of an employee trust, paragraph 107.1(*a*) requires the trust to recognize a gain or loss when it distributes trust property to a beneficiary by treating the trust as having disposed of the property at its fair market value immediately before the time of distribution. That paragraph also ensures that the beneficiary is considered to acquire the property at that fair market value.

Section 107.1 is amended so that paragraph 107.1(*a*) applies to a trust described in paragraph (*a*.1) of the definition "trust" in subsection 108(1). This is intended to ensure that, in the unusual circumstance that property other than cash is distributed by the trust, there is a recognition in the trust of any gain or loss in respect of the property. For more on new paragraph (*a*.1) of the definition "trust" in subsection 108(1), see the commentary on that subsection.

This amendment applies to the 1999 and subsequent taxation years.

Clause 52

Qualifying Disposition

ITA
107.4(1) to (3)

The portion of the note on these subsections that is under the heading "*New subsections 107.4(1) to (3)*" is replaced by the following:

New subsections 107.4(1) to (3)

As discussed above, subsection 107.4(3) generally provides a rollover whenever there is a qualifying disposition of property to a trust. Under new subsection 107.4(1), a "qualifying disposition" of property is a "disposition" (as defined in subsection 248(1)) of the property as a result of a transfer to a particular trust where

- because of the disposition, there is no change in the beneficial ownership of the property,
- the proceeds would not, disregarding sections 69 and 73, be determined under any other provision of the Act (e.g., transfers from a trust to a beneficiary under the trust where the proceeds are determined under subsection 107(2)),
- the disposition is neither by a person resident in Canada to a non-resident trust nor a transfer of taxable Canadian property from a non-resident person who was resident in Canada in any of the ten calendar years preceding the transfer to a non-resident trust,
- the disposition is not by a partnership (other than a partnership each member of which is non-resident) to a non-resident trust,
- the disposition is not by a partnership, if the disposition is part of a series of transactions or events beginning after December 17, 1999 that includes the cessation of the partnership's existence and a subsequent distribution from a personal trust to a former member of the partnership in circumstances to which subsection 107(2) applies,

- immediately after the disposition, unless the contributor is a trust, there is no absolute or contingent right as a beneficiary under the particular trust for any beneficiary other than the contributor or joint contributors, as the case may be. (For this purpose, there is a restricted meaning under new subsection 104(1.1) associated with the expression "beneficiary".),

- the disposition does not occur after December 17, 1999 if the disposition is, or is part of, a transaction where the contributor receives for the disposition any consideration (other than consideration that is an interest of the contributor as a beneficiary under the particular trust or the assumption by the particular trust of debt for which the property may at the time of the disposition reasonably be considered to be security),

- the disposition is not to a trust described in any of paragraphs (*a*) to (*e*.1) of the definition "trust" in subsection 108(1) (generally trusts relating to employee compensation and retirement savings and trusts deemed to exist for income tax purposes), except if it is a disposition by a trust so described,

- the disposition is not part of a series of transactions or events

  - that begins after December 17, 1999 and that includes the disposition of any interest in a personal trust (other than a disposition solely as a consequence of a distribution from the trust),

  - that begins after December 17, 1999 and that includes the subsequent acquisition, for consideration given to a personal trust, of any interest in the trust, or

  - that begins after June 5, 2000 and that includes the transfer to the particular trust of particular property as consideration for the acquisition of a capital interest in the particular trust, if the particular property can reasonably be considered to have been received in order to fund a distribution from the other trust (other than a distribution that is proceeds of disposition of a capital interest in the particular trust),

- subsection 73(1) would not apply to the disposition if no election were made under that subsection and there were no restrictions in

subsection 73(1.02) as to the circumstances in which subsection 73(1) applies, and

- where the contributor is an amateur athlete trust, a cemetery care trust, an employee trust, an *inter vivos* trust deemed by subsection 143(1) to exist in respect of a congregation that is a constituent part of a religious organization, a related segregated fund trust (as defined in section 138.1), a trust described in paragraph 149(1)(*o*.4) or a trust governed by an eligible funeral arrangement, an employees profit sharing plan, a registered education savings plan or a registered supplementary unemployment benefit plan, the particular trust is the same type of trust. For example, if the contributor is a related segregated fund trust, the particular trust must also be a related segregated fund trust.

Subsection 107.4(2) provides a supplementary rule that applies for the purpose of paragraph 107.4(1)(*a*). Paragraph 107.4(2)(*a*) is designed to allow for the division of properties among trusts in certain cases. Consider, for example, the situation where 1,000 shares of ABC Corp. are held in trust A for beneficiaries X and Y. Assume that X has a 30 per cent interest in the trust and Y has the remaining 70 per cent interest. If 300 shares are transferred to trust B for X and the remaining 700 shares are transferred on the same day to trust C for Y, there has been no change in the economic interests of X and Y. Paragraph 107.4(2)(*a*) provides that, in these circumstances, the requirement in paragraph 107.4(1)(*a*) that there be no change in beneficial ownership is satisfied in the event that trust A receives no consideration. Consequently, assuming the other conditions under subsection 107.4(1) are satisfied, there would be a qualifying disposition of the 300 shares to trust B and another qualifying disposition of the 700 shares to trust C.

Paragraph 107.4(2)(*b*) deems there to be no change in beneficial ownership of a property where the property is transferred from a trust governed by an RRSP or RRIF to another trust governed by an RRSP or RRIF, provided that the annuitant of the transferor is the same as that of the transferee. The application of paragraph 107.4(2)(*b*) is illustrated in the following example.

EXAMPLE

Tom is the annuitant of an RRSP under which Laura is named as the beneficiary. The property is transferred from that RRSP trust to another trust governed by an RRSP under which Tom is the annuitant and under which Michelle is named as beneficiary. Assume that, because of an election or otherwise, neither paragraph (f) nor (g) of the definition "disposition" in subsection 248(1) of the Act applies.

Results:

1. In these circumstances, paragraph 107.4(2)(b) deems, for the purpose of paragraph 107.4(1)(a), there to be no change in beneficial ownership.

2. Consequently, there should be a qualifying disposition of the property.

Paragraph 107.4(2)(*b*) is part of a set of amendments intended to clarify the tax treatment of transfers of property involving RRSPs and RRIFs. For further detail, see the commentary on paragraphs 107.4(3)(*c*) and (*f*) and (*g*) of the new definition "disposition" (in subsection 248(1)) and subsections 206(4) and 248(25.1).

Under paragraph 107.4(3)(*a*), the transferor's proceeds from the qualifying disposition are generally deemed to be the cost amount of the property. However, provision is made for the transferor to elect another amount, between the cost amount of the property and its fair market value, as proceeds.

Under paragraph 107.4(3)(*b*), the proceeds determined under paragraph (*a*) are also generally treated as the cost to the transferee trust of the property. However, this amount is reduced in some cases where the fair market value of the property is less than the cost amount. The reduction in these cases is equal to a hypothetical reduction in the transferor's loss on the disposition of the property. This hypothetical reduction is computed, using the stop-loss rules with regard to partnership interests (subsection 100(4)), trust interests (paragraphs 107(1)(*c*) and (*d*)) and shares (subsections 112(3) to (4.2)), on the assumption that the proceeds of disposition are the fair market value of the property rather than its cost amount.

Paragraph 107.4(3)(*b*) does not, however, apply for the purpose of the foreign property limit under Part XI. For this purpose, except for transfers before 2000 between RRSP trusts and RRIF trusts, the cost amount to the transferor under paragraph 107.4(3)(*c*) is the cost to the transferee of the same property unless the transferee elects that the cost be the fair market value of the property at the time of its transfer. (It is expected that this election will be used only if the transferee trust does not have information with regard to the cost amount of property from the transferor trust. If, on the other hand, the election is made for the purpose of avoiding Part XI tax, it is invalid.) With regard to the excepted transfers involving RRSPs and RRIFs, the transferee's cost of the property is its fair market value unless the transferee files the election described in subparagraph 107.4(3)(*c*)(i). (If this election is made for the purpose of avoiding Part XI tax, it is invalid.) For further detail on transfers involving RRSPs and RRIFs see the commentary, including examples, on paragraph (*g*) of the new definition "disposition" in subsection 248(1).

In addition, where the property is depreciable property or eligible capital property, there are rules in paragraphs 107.4(3)(*d*) and (*e*) designed, for the purposes of the capital cost allowance rules in the Act, to put the transferee in the same position as the transferor in the event that the transferee subsequently disposes of the property. These rules are parallel to existing rules in subsection 107(2) for trust distributions to beneficiaries.

Paragraph 107.4(3)(*f*) provides that, if the property was deemed to be taxable Canadian property of the transferor because of a number of specified provisions in the Act, the property retains that character in the hands of the transferee.

Paragraph 107.4(3)(*g*) provides that, where the transferor is a related segregated fund trust (as defined in section 138.1 of the Act), paragraph 138.1(1)(*i*) does not apply in respect of a disposition of an interest in the transferor that occurs in connection with the qualifying disposition. Consequently, no capital loss is provided on the qualifying disposition under paragraph 138.1(1)(*i*) in respect of load fees associated with a policyholder's interest in the transferor. Paragraph 107.4(3)(*g*) also ensures that such amounts can ultimately be recognized on a disposition of an interest in the transferee trust.

Paragraph 107.4(3)(*h*) applies if the transferor was a trust to which property was transferred by an individual (other than a trust) in anticipation of ceasing to reside in Canada and in circumstances to which subsection 73(1) applied. For the purposes of paragraph 104(4)(*a*.3), the transferee trust is likewise deemed to be a trust to which the individual had transferred property in circumstances to which subsection 73(1) applied and in anticipation of ceasing to reside in Canada. Thus, as a consequence of new paragraph 104(4)(*a*.3), there may be a deemed disposition by the transferee trust on the individual ceasing to reside in Canada. Paragraph 107.4(3)(*h*) also applies, where property was transferred by an individual (other than a trust) to the transferor trust in circumstances to which subsection 107.4(3) would apply if no exception under subsection 107.4(1) were made for either transfers to which subsection 73(1) applied or transfers that included the giving to the transferor of any consideration. In these circumstances, the transferee trust is deemed for the purposes of paragraph (*j*) of the definition "excluded right or interest" in subsection 128.1(10) to be a trust an interest in which was acquired by the individual as a consequence of a qualifying disposition. Thus, gains with regard to an interest in the transferee trust would be required to be recognized in the event that the individual subsequently ceases to reside in Canada.

Paragraph 107.4(3)(*i*) applies where the transferor was a trust that was neither a personal trust nor a trust prescribed for the purposes of subsection 107(2). In these circumstances, the transferee trust is likewise deemed to be neither a personal trust nor a trust prescribed for the purposes of subsection 107(2).

Paragraph 107.4(3)(*j*) applies where, as a result of a qualifying disposition from one trust to another trust, a taxpayer disposes of the taxpayer's capital interest in the transferor trust and acquires a capital interest in the transferee trust. In these circumstances, the taxpayer is deemed to dispose of the capital interest in the transferor trust for proceeds equal to the cost amount to the taxpayer of that interest. The taxpayer is also generally deemed to acquire the interest in the transferee trust at that same cost amount. However, the deemed cost amount to the taxpayer of the taxpayer's capital interest in the transferee trust is reduced in some cases where the fair market value of the taxpayer's capital interest in the transferor trust is less than its cost amount to the taxpayer. The reduction in these cases is equal to a hypothetical reduction in the transferor's loss on the disposition of

the property. This hypothetical reduction is computed, using the stop-loss rules with regard to trust interests (paragraphs 107(1)(*c*) and (*d*)), on the assumption that the proceeds of disposition are the fair market value of the property rather than its cost amount.

Paragraph 107.4(3)(*k*) applies where the transferor is a trust and a taxpayer's beneficial ownership in property ceases because of a qualifying disposition to be derived from the taxpayer's capital interest in the transferor, but no part of the taxpayer's capital interest in the transferor was disposed of because of the qualifying disposition. In these circumstances, the taxpayer's cost of the taxpayer's capital interest in the transferee trust is increased to reflect the percentage change (attributable to the disposition) in value of the taxpayer's capital interest in the transferee trust. However, the cost amount of the taxpayer's interest in the transferee trust is reduced where the fair market value of the taxpayer's capital interest in the transferor is less than its cost amount to the taxpayer and, had the capital interest in the transferor trust been disposed of, the taxpayer's loss from that hypothetical disposition would have been reduced under the stop-loss rules for trust interests (paragraphs 107(1)(*c*) and (*d*)).

Paragraph 107.4(3)(*l*) generally provides that any amount added under that paragraph in computing the cost to a taxpayer of the taxpayer's capital interest in a transferee trust is deducted in computing the cost to a taxpayer of the taxpayer's capital interest in the transferor. However, the amount of the deduction does not take into account the reduction under paragraph 107.4(3)(*k*) in respect of the stop-loss rules for trust interests.

Where paragraphs 107.4(3)(*j*) and (*k*) do not apply, paragraph 107.4(3)(*m*) deems the cost to the transferor of the capital interest in the transferee trust acquired on the disposition to be

- where the transferee is a personal trust, nil, and

- in any other case, the excess determined under paragraph 107.4(3)(*b*).

Paragraph 107.4(3)(*n*) applies to a qualifying disposition that is a disposition of a property between two personal trusts. Where, because of the qualifying disposition, a taxpayer disposes of an

income interest (as defined in subsection 108(1)) in the transferor trust and acquires an income interest in the transferee trust, for the purpose of subsection 106(2) the taxpayer is deemed not to dispose of any part of the income interest in the transferor trust. This measure is limited to personal trusts because an income interest only exists in respect of such trusts.

These amendments apply to dispositions that occur after December 23, 1998. However, in order to ensure that there will be a cost assigned in certain cases to property previously transferred, these amendments also apply, except for the purposes of Part XI of the Act and regulations made for the purpose of that Part, in simplified form to the 1993 and subsequent taxation years. The previous transfers to which the simplified rules apply are transfers (other than transfers to bare trusts) that were not dispositions of property because of paragraph (*e*) of the definition "disposition" in section 54. No proceeds of dispositions are ascribed to these previous transfers and the stop-loss rules in subsection 107.4(3) do not apply.

Clause 53

Trusts

ITA
108(1)

"accumulating income"

The amount that may be allocated under subsection 104(15) of the Act to a disabled beneficiary for a trust taxation year is limited to the trust's accumulating income for the year. The trust's accumulating income is designed, in part, to ensure that the preferred beneficiary election cannot be used to allocate income and gains under a spousal trust to non-spouse beneficiaries. Under the existing definition, trust income arising from a deemed disposition of trust assets under subsection 104(4), (5) or (5.2) is not included in computing "accumulating income" and cannot be allocated to beneficiaries in the event that the trust is a spousal trust.

The definition "accumulating income" is amended so that the above restriction only applies in connection with the deemed disposition of

trust assets that occurs on the death of the spouse beneficiary under a spousal trust. As a consequence of amendments to paragraph 104(4)(*a*), a similar restriction applies to *alter ego* trusts and joint partner trusts, as defined in subsection 248(1).

This amendment applies to the 2000 and subsequent taxation years.

This amendment also reflects changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act*.

ITA
108(1)

"trust"

Subsection 108(1) of the Act defines "trust", for the purposes of the 21-year deemed disposition rule and other specified measures, to exclude certain listed trusts. For these purposes, paragraph (*f*) of the definition excludes unit trusts (as defined in subsection 108(2)) and paragraph (*g*) of the definition excludes, except as specified, trusts all interests in which have vested indefeasibly and no interest in which may become effective in the future. One of the specified exceptions from the exclusion under paragraph (*g*) is for trusts described in paragraph 104(4)(*a*) (which, under the existing law, describes only spousal trusts).

Paragraph (*a*.1) is added to the definition so that the exclusion from the 21-year deemed disposition rule and other rules applies to a trust (other than a trust already described in paragraph (*a*) or (*d*) of the definition) all or substantially all of the property of which is held for the purpose of providing benefits to individuals each of whom is provided with benefits in respect of, or because of, an office or employment or former office or employment. It is generally intended that health and welfare trusts qualify for the exclusion, given that these trusts would not be expected to be described in paragraph (*a*) or (*d*) of the definition. This amendment applies to the 1999 and subsequent taxation years.

The definition is also amended so that the exclusion under paragraphs (*f*) and (*g*) also apply for the purpose of the rules in section 106 governing the taxation of income interests.

Paragraph (*g*) of the definition is amended so that the exclusion can apply to a trust all interests in which have vested indefeasibly, without regard to whether an interest in the trust becomes effective in the future. However, under new subparagraph (*g*)(v), the exclusion generally does not apply to a trust under the terms of which all or part of any person's interest is to be terminated with reference to a period of time.

The elimination of the requirement that there be no future interest and its replacement by subparagraph (*g*)(v) applies to the 1998 and subsequent taxation years. However, where the trust so elects in writing before its filing-due date for its taxation year that includes the date of Royal Assent (or before such later day as is acceptable to the Minister of National Revenue), these amendments apply only after 2000.

EXAMPLE

A trust provides for beneficiary A to receive income from property for the lifetime of beneficiary A with the remainder interest to go beneficiary B (or the estate of beneficiary B, if beneficiary B does not survive beneficiary A). The above amendment clarifies that the above exclusion from the 21-year rule does not apply in this case. On the other hand, where new units in a trust can be issued by a commercial trust for fair market value consideration, the above amendment ensures that the trust is not precluded from qualifying for the exclusion.

New subparagraph (*g*)(iv) of the definition ensures that the above exclusion does not apply to a trust resident in Canada that has a non-resident beneficiary, unless the total fair market value of the interests of the non-resident beneficiaries is 20% or less of the total fair market value of the interests in the trust. This 20% level is meant to accommodate a limited level of foreign ownership of interests in the trust, given that gains in respect of those interests may not be subject to Canadian taxes because of income tax treaties. This amendment applies after December 23, 1998.

New subparagraph (*g*)(vi) of the definition ensures that the above exclusion does not apply to a trust that, after December 17, 1999, made a distribution to a beneficiary in respect of the beneficiary's capital interest in the trust, if the distribution may reasonably be

considered to have been financed by a liability of the trust and one of the purposes of incurring the liability was to avoid taxes otherwise payable under Part I of the Act as a consequence of the death of any individual. This provision parallels new paragraph 104(4)(*a*.2), described in the notes above.

Except as noted above, these amendments apply to the 1998 and subsequent taxation years.

ITA
108(2)

The last paragraph of the note on this subsection is replaced by the following:

Paragraph 108(2)(*b*) is also amended to add a reference to "hypothec" to the list of properties the combination of which must account for at least 80 per cent of a trust's total properties. This amendment is made to ensure that the Act appropriatly reflects both the civil law of the province of Quebec and the law of other provinces.

These amendments apply to the 1998 and subsequent taxation years.

ITA
108(4)

The last paragraph of the note on this subsection is replaced by the following:

This amendment applies to the 2000 and subsequent taxation years.

This provision is further amended to reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act.*

ITA
108(7)

A "personal trust" is defined in subsection 248(1) of the Act as essentially a testamentary trust or an *inter vivos* trust in which no beneficial interest was acquired for consideration payable to the trust or to a contributor to the trust. An existing special rule within the definition generally ensures that one person (or two or more related

persons) can make contributions to a trust and retain an interest under the trust without the prohibition on consideration being considered to apply. This existing rule also applies for the purposes of paragraph 53(2)(*h*), which deals with the calculation of the adjusted cost bases of certain trust interests.

The definition is amended so that this special rule is removed from the definition. Instead, the special rule is now provided in new subsection 108(7). The special rule also is to apply, under subsection 108(7), for the purposes of amended subsection 107(1), strictly as a consequence of the amendments to that provision and for the purposes of paragraph (*j*) of the new definition "excluded right or interest" in subsection 128.1(10).

New subsection 108(7) also ensures that, for the purposes of the above-noted provisions, an interest in a trust is deemed not to be acquired for consideration solely because of the acquisition of the interest in satisfaction of any right as a beneficiary under the trust to enforce payment from the trust.

New subsection 108(7) applies after December 23, 1998.

Clause 56

Trust Deduction

ITA
110.6(12)

Subsection 110.6(12) of the Act generally allows spousal trusts access to the unused lifetime capital gains exemption of the beneficiary spouse, for the taxation year of the spousal trust in which the beneficiary spouse dies. Under paragraph 104(4)(*a*), there is generally a deemed disposition for a post-1971 partner trust once the beneficiary spouse dies.

Subsection 110.6(12) is amended to ensure that it does not apply to *alter ego* trusts or joint partner trusts (as newly defined in subsection 248(1)). This amendment is consequential to the extension of paragraph 104(4)(*a*) to provide for deemed dispositions for *alter ego* trusts and joint partner trusts.

This amendment applies to the 2000 and subsequent taxation years.

Clause 60

Non-resident's Taxable Income in Canada

ITA
115

The fourth paragraph of the note on subsection 115(1) is replaced by the following:

This amendment generally applies to the 1998 and subsequent taxation years. In addition, if an individual ceased to be resident in Canada after 1992 and before October 2, 1996, and the individual so elects, this amendment applies to income received by the individual after that cessation of residence. The election in effect backdates the explicit exclusion of certain income rights and trust interests from the deemed disposition immediately before emigration. The basis for excluding the rights in question from the deemed disposition is that they generally represent entitlements to future income that will itself be subject to Canadian tax when it is received by a non-resident. Linking the application of amended subparagraph 115(1)(*a*)(i) to the election ensures that the Act does tax that income, where it relates to employment exercised abroad by a resident of Canada.

Interests or Options in Property

ITA
115(3)

Subsection 115(3) of the Act provides that, for the purposes of section 115 of the Act, taxable Canadian property includes an interest in, or an option in respect of, a property, regardless of whether or not the property is in existence. Because the definition "taxable Canadian property" has been moved from subsection 115(1) to subsection 248(1) of the Act, and the new definition contains in paragraph (*l*) a similar rule for interests and options, subsection 115(3) is no longer needed and is repealed, effective after October 1, 1996.

Clause 62

Personal Credits – In-home Care of Relatives

ITA
118(1)B(*c*.1)

The following is added at the end of the note on this paragraph.

This amendment also reflects changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act*.

Clause 66

Former Resident – Credit for Tax Paid

ITA
119

The first paragraph of the note on this section is replaced by the following:

Existing section 119 of the Act provides for a five-year block averaging for farmers and fishermen. Since the section is no longer active, it is repealed effective for the 1995 and subsequent taxation years.

New section 119 of the Act, which is unrelated to repealed section 119, provides a special tax credit in certain cases where the "stop-loss" rule in new subsection 40(3.7) of the Act applies to an individual who ceased to be resident in Canada.

Clause 67

Income Not Earned in a Province

ITA
120

The last paragraph of the note on this section is replaced by the following:

Subsection 120(4) includes a definition of "tax otherwise payable under this Part". The amendment to this subsection, which applies to the 1996 and subsequent taxation years, excludes from the definition any deduction from tax in respect of the new credit, under section 119 of the Act, for certain taxes paid by a former resident of Canada. In order to take into account an amendment to the definition of "tax otherwise payable under this Part" in the 1999 budget bill (Bill C-25), a special transitional rule is provided for taxation years that end before 2000.

Clause 69

Tax Payable by *Inter Vivos* Trust

ITA
122(2)

Subsection 122(1) provides that *inter vivos* trusts are generally subject to income tax at top marginal income tax rates. Subsection 122(2) of the Act permits certain pre-1972 *inter vivos* trusts access to graduated income tax rates.

Subsection 122(2) is amended to ensure that this special treatment does not apply to a trust in the event that property has been transferred after December 17, 1999 to the trust from another trust to which subsection 122(1) applies, if there was no change in the beneficial ownership of the property on its transfer.

This amendment applies to the 1999 and subsequent taxation years.

Clause 74

Foreign Tax Credit

Former Resident

ITA
126(2.21) and (2.22)

In some circumstances, an individual who is a former resident of Canada may be subject to tax in another country on a gain that accrued while the individual was resident in Canada, and that has already been subject to Canadian tax on emigration. Similarly, the non-resident beneficiary of a Canadian trust who receives trust property on a distribution may be taxed abroad on a gain that accrued while the property was held by the trust, and that has been taxed in Canada on the distribution.

EXAMPLE – double taxation of pre-departure gain

Lee emigrates from Canada to Treatyland at a time when he owns a house in Treatyland. Lee bought the house while resident in Canada; at the time of emigration, the house has an adjusted cost base of $60,000 and a fair market value of $100,000. The resulting $40,000 latent capital gain will produce a taxable capital gain of $30,000 immediately before departure, and that taxable capital gain will be subject to Canadian tax.

Assume that the house increases in value to $120,000 after Lee leaves Canada, and that Lee sells the property in 2005 for that amount.

In principle, the gain that has been subject to Canadian tax ought not to be taxed a second time. However, Treatyland may not yet recognize the tax effect of changes in residence and may simply tax Lee, when the property is disposed of, on the full amount of the his gain since first acquiring the property. In that case, Treatyland will tax not only the $20,000 gain realized since Lee left Canada, but also the $40,000 gain that accrued while Lee was resident in Canada. In the end, Lee is taxed twice on the same gain.

The best way to alleviate such results is to modify Canada's tax treaties to ensure appropriate recognition for the Canadian tax that

arises on departure. However, treaty changes can take considerable time. As an interim measure, new subsection 126(2.21) provides limited credits against an individual's Canadian tax that arises in the year of the individual's departure from Canada, for post-departure foreign taxes. These foreign taxes can comprise both business-income and non-business-income taxes (defined in subsection 126(7)). New subsection 126(2.22) provides similar limited credits against a trust's Canadian tax that arose in the year of a distribution by the trust to a non-resident beneficiary, for the beneficiary's subsequent foreign taxes. It is intended that these interim foreign tax credits will be reviewed by the Government of Canada as appropriate treaty changes are put in place.

Subsections 126(2.21) and (2.22) will apply, in most cases, only for taxes paid to countries with which Canada has a tax treaty. Exceptions are provided for taxes imposed by a foreign country on gains on real property situated in that country. In keeping with the general international principle that the country in which real property is located has the first right to tax gains on that real property, Canada will always provide credit for such taxes. Similarly, credit for those taxes will be available regardless whether Canada has a tax treaty with the particular country.

More specifically, subject to the conditions described above, the credit provided to an individual under new subsection 126(2.21) is computed on a property-by-property basis, as the lesser of two amounts.

The first amount, described in paragraph 126(2.21)(*a*), is the total of those portions of the foreign taxes paid in respect of the disposition of the property that can reasonably be considered to relate to the portion of the gain or profit in question that arose before the individual's emigration from Canada. Where the property in question is real property situated outside Canada, the creditable taxes are those paid to the government of the country where the property is located or, to the government of another country in which the individual is resident and with which Canada has a tax treaty.[2]

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[2] Note that a tax paid to the government of a political subdivision of a country is included for this purpose in the taxes paid to the government of the country. See the definitions "business-income tax" and "non-business-income tax" in subsection 126(7) of the Act.

The second amount, described in paragraph 126(2.21)(*b*), is in effect the amount of the individual's tax under Part I of the Act for the year of emigration that is attributable to the deemed disposition of the particular property under paragraph 128.1(4)(*b*) of the Act. In determining this amount, previous applications of subsection 126(2.21) are taken into account.

EXAMPLE – operation of new credit

In the example above, Lee will be able to claim a credit for the lesser of 2/3 ($40,000/$60,000) of the Treatyland tax on the total amount of the gain, and the Canadian tax that arose because of the deemed disposition on emigration. The credit will be applied against Lee's Canadian tax for the emigration year, with amended subsection 152(6) allowing any necessary reassessment.

Note that since the property in question (a house) is real property, Lee could also claim a credit for tax paid to another treaty country in respect of his pre-emigration gain, if he lived in that other country. For example, if the house were located not in Treatyland but in Nontreatyland, Lee could – as a resident of Treatyland – claim a credit in respect of both Treatyland tax and Nontreatyland tax .

New subsection 126(2.22) sets out a comparable rule in respect of distributions after October 1, 1996 by Canadian-resident trusts to non-resident individuals. While the general operation of this rule is very similar to that of new subsection 126(2.21), it should be noted that in this case the credit involves two taxpayers: foreign taxes paid by the beneficiary are creditable against Canadian taxes paid by the trust.

A consequential amendment to subsection 152(6) of the Act ensures that any necessary assessments of tax will be made in order to take account of the effect of new subsections 126(2.21) and (2.22).

New subsections 126(2.21) and (2.22) apply to the 1996 and subsequent taxation years.

Where Foreign Credit Available

ITA
126(2.23)

New subsection 126(2.23) of the Act limits the availability of the new foreign tax credits under subsections 126(2.21) and (2.22). This rule requires that in computing, for the purposes of these new credits, the foreign tax an individual has paid in respect of the disposition of a property, the individual must first take into account any relevant tax credit (or other reduction in tax) that the individual is entitled to in respect of the property under the law of a foreign country or under a tax treaty between Canada and a foreign country. This is intended to ensure that the credits under new subsections 126(2.21) and (2.22) are only available to the extent that another country is not required to give credit for Canadian tax in respect of the disposition or a prior disposition of the property.

Subsection 126(2.23) applies to the 1996 and subsequent taxation years.

Clause 77

Immigration

Changes in Residence

ITA
128.1(1)(*b*)(iv) and (v)

The second paragraph of the note on these subparagraphs is replaced by the following:

New subparagraph 128.1(1)(*b*)(iv) excludes from the deemed disposition on immigration any property (other than an interest acquired for no consideration in a non-resident testamentary trust) that is an "excluded right or interest" of the taxpayer. As defined in new subsection 128.1(10) of the Act, the term "excluded right or interest" includes many kinds of income rights and other properties. Since the term also encompasses rights under agreements referred to in subsections 7(1) and 7(1.1) of the Act (options of employees to

acquire shares of a corporation or units of a mutual fund trust), existing subparagraph 128.1(1)(*b*)(v), which refers only to employee stock options, is unnecessary and is repealed.

Deemed Disposition

ITA
128.1(4)(*b*)

Paragraph 128.1(4)(*b*) treats a taxpayer who ceases to be resident in Canada as having disposed of the taxpayer's property, for proceeds equal to fair market value. This disposition is deemed to have taken place at a "time of disposition" that is immediately before the time that is immediately before the time the taxpayer ceases to be resident. The time of cessation of residence is referred to in the provision as the "particular time" and in these notes as the "emigration time."

Where the taxpayer is an individual, certain types of property are exempted from the deemed disposition. These properties, generally, are those that would be subject to Canadian taxation in the hands of a non-resident.

Paragraph 128.1(4)(*b*) is amended to ensure that this policy is better reflected in the legislation. Under amended paragraph 128.1(4)(*b*), an individual emigrant from Canada is treated as having disposed of all property other than:

(i) real property situated in Canada, Canadian resource properties and timber resource properties;

(ii) property of a business carried on by the individual, at the emigration time, through a permanent establishment in Canada – including capital property, eligible capital property and property described in the inventory of the business;

(iii) property that is an "excluded right or interest" of the individual. As defined in new subsection 128.1(10) of the Act, the term "excluded right or interest" includes many kinds of income rights and other properties. See the commentary on new subsection 128.1(10) for more details;

(iv) certain property of short-term residents (see below); and

(v) certain property of a short-term non-resident (see the commentary on new subsection 128.1(6) of the Act).

Since the definition “excluded right or interest” in new subsection 128.1(10) encompasses rights under agreements referred to in subsections 7(1) and 7(1.1) of the Act (options of employees to acquire shares of a corporation or units of a mutual fund trust), existing subparagraph 128.1(4)(*b*)(vi), which refers only to employee stock options, is unnecessary and is repealed.

Under new subparagraph 128.1(4)(*b*)(iv), an individual (other than a trust) who has been resident in Canada for 60 months or less during the 10-year period preceding the cessation of residence is not deemed to dispose of any property that the individual owned on becoming resident in Canada, or that the individual inherited after becoming resident here. (This exception was formerly provided under subparagraph 128.1(4)(*b*)(v) of the Act.)

Where an individual (other than a trust) ceases to be resident in Canada after October 1, 1996 and re-establishes Canadian residence at a later time, a special rule, set out in new subsection 128.1(6), enables the individual to exclude all property from the deemed disposition in respect of the cessation of residence. For additional information, see the commentary on subsection 128.1(6).

Two additional points should be noted. First, where an emigrating individual owns shares of a corporation which owns a life insurance policy under which the individual’s life is insured, upon the deemed disposition at departure of the individual's shares in the corporation, a special rule contained in amended subsection 70(5.3) of the Act will be used in the valuation of the corporation's shares – the cash surrender value of the life insurance policy owned by the corporation will be treated as the fair market value of that policy. Second, the Regulations will be amended after these amendments receive Royal Assent, so that the definition “permanent establishment” in section 8201 of the Regulations will apply for the purpose of subparagraph 128.1(4)(*b*)(ii) of the Act.

Amended paragraph 128.1(4)(*b*) generally applies after October 1, 1996. In addition, an individual who ceased to be a Canadian resident after 1992 and before October 2, 1996 may also elect to exclude from the deemed disposition at emigration property described

in the definition “excluded right or interest” in new subsection 128.1(10) of the Act. This election must be made in writing filed with the Minister of National Revenue within six months of these amendments receiving Royal Assent. It should also be noted that this election will cause amended subparagraph 115(1)(*a*)(i) of the Act to apply. For additional information, see the commentary on subsection 115(1).

Returning Former Resident

ITA
128.1(6)

The sixth paragraph of the note on this subsection is replaced by the following:

Paragraph 128.1(6)(*a*) allows the individual to make an election in respect of property that was taxable Canadian property at the emigration time and throughout the period that the individual was non-resident. The effect of making this election is that paragraphs 128.1(4)(*b*) and (*c*) do not apply in respect of all such properties of the individual for the taxation year that includes the emigration time.

The first paragraph that precedes “*EXAMPLE – 128.4(6)(c)*” in the note on this subsection is replaced by the following:

As a result of these adjustments, the returning individual can generally defer Canadian tax on gains that had accrued before emigration, while still protecting from Canadian tax gains that accrued during periods of non-residence.

Returning Trust Beneficiary

ITA
128.1(7)

New subsection 128.1(7) of the Act provides special rules, which parallel new subsection 128.1(6) of the Act, applicable to an individual trust beneficiary (other than one that is itself a trust) who emigrates from Canada, receives distributions of trust property as a non-resident, and then re-establishes residence in Canada while still owning the property. In general terms, these rules allow the

beneficiary and the trust to jointly elect, upon the beneficiary's return to Canada, to unwind the tax consequences to the trust that occurred when it distributed the property to the non-resident beneficiary.

A number of conditions must be met for the application of these rules: the individual must have been a resident of Canada and then ceased to be resident in Canada after October 1, 1996; the individual must have been a beneficiary of the trust at the time he or she ceased to be resident in Canada; the distribution must occur after October 1, 1996 and before the individual re-establishes residence in Canada; the distribution must be such that subsection 107(2) of the Act would have applied but for subsection 107(5); and the individual must re-establish residence in Canada after October 1, 1996 while still owning the property distributed by the trust.

Where these conditions are met, paragraph (*d*) provides an election for taxable Canadian property similar to the election provided in paragraph 128.1(6)(*a*). Paragraphs (*e*) and (*f*) provide anti-stripping rules similar to those provided by paragraph 128.1(6)(*b*). Paragraph (*g*) provides an election for property other than taxable Canadian property, similar to the election provided in paragraph 128.1(6)(*c*).

Paragraph (*h*) provides a special rule applicable if the trust ceases to exist before the individual's filing-due date for his or her taxation year during which he or she re-establishes residence in Canada. In such cases, the elections or specifications provided in new subsection 128.1(7) can be made by the individual alone. However, the individual and the trust will then be jointly and severally liable for any amount payable under the Act by the trust as a result of the election or specification.

Paragraph (*i*) allows any assessment of tax to be made that is necessary for the elections under new subsection 128.1(7) to be taken into account, but provides that no such assessment shall affect the computation of interest or penalties payable.

New subsection 128.1(7) applies to changes in residence that occur after October 1, 1996. A special transitional rule accommodates individuals who cease to be resident in Canada after October 1, 1996 and before these amendments receive Royal Assent, and who wish to make elections under new subsection 128.1(7). The elections for these transition period emigrants will be considered to have been

made in a timely manner if they are made on or before the individual's filing-due date for the taxation year that includes the day on which Royal Assent is received.

In addition, it is proposed that the Regulations be amended to ensure that the Minister of National Revenue has discretion under the "fairness package" to allow elections under new subsection 128.1(7) to be late-filed.

Post-emigration Loss

ITA
128.1(8)

New subsection 128.1(8) of the Act provides relief to an individual (other than a trust) who disposes of a taxable Canadian property, after having emigrated from Canada, for proceeds that are less than the deemed proceeds that arose under paragraph 128.1(4)(*b*) in respect of the property when the individual emigrated.

Under subsection 128.1(8) the individual may elect to reduce the proceeds of disposition that were deemed to arise under paragraph 128.1(4)(*b*) in respect of a property by the least of:

- an amount specified by the individual;

- the amount that would be the individual's gain from the deemed disposition of the property under paragraph 128.1(4)(*b*), but for this subsection; and

- the amount that would be the individual's loss from the disposition of the property at the time the property is actually disposed of, if the loss were determined with reference to every other provision in the Act (including the stop-loss rules in subsection 40(3.7) and section 112 of the Act) but this subsection.

The same amount is added to the individual's proceeds of disposition realized at the time of actual disposition.

EXAMPLE – 128.1(8)

Odile emigrates from Canada in 1999, owning a capital interest in a trust resident in Canada that she purchased in 1997. The interest has a fair market value at the emigration time of $150,000 and an adjusted cost base of $40,000, for a latent gain of $110,000 on departure. Odile's tax is assessed on that basis, and she posts security for the tax.

In 2001, Odile sells her trust interest for $60,000. Since Odile has realized a smaller gain than assumed in her tax assessment on emigration, she elects under subsection 128.1(8) to reduce the gain she was deemed to have realized when she emigrated.

To obtain the maximum benefit from the subsection, Odile specifies an amount of $90,000 in respect of the election. Her proceeds of disposition at the emigration time are deemed to be $60,000, being the proceeds of disposition that would otherwise be determined under paragraph 128.1(4)(b) ($150,000) minus the least of:

- *the amount specified ($90,000);*
- *the amount that would have been her taxable gain in respect of the trust interest under 128.1(4)(b) had this paragraph not applied ($110,000); and*
- *the amount that would have been her loss on actual disposition of the trust interest had this paragraph not applied ($150,000 - $60,000 = $90,000).*

The same $90,000 amount is added to Odile's proceeds of the actual disposition of the trust interest. The result is that, in respect of the trust interest, Odile is treated as having realized a $20,000 gain in 1999, and no gain or loss on the actual disposition of the property in 2001.

It should be noted that the election in subsection 128.1(8) does not affect any interest or penalties owing by the individual at the time of making the election, including interest and penalties levied on taxes in respect of the property, calculated without reference to the subsection.

A consequential amendment to subsection 152(6) of the Act ensures that any necessary assessments of tax will be made in order to take account of the effect of new subsection 128.1(8).

New subsection 128.1(8) applies to changes in residence that occur after October 1, 1996. A special transitional rule accommodates individuals who cease to be resident in Canada after October 1, 1996 and before these amendments receive Royal Assent, and who wish to make the election under new subsection 128.1(8). The election for these transition period emigrants will be considered to have been made in a timely manner if it is made on or before the individual's filing-due date for the taxation year that includes the day on which Royal Assent is received.

In addition, the Regulations will be amended to ensure that the Minister of National Revenue has discretion under the "fairness package" to allow an election under new subsection 128.1(8) to be late-filed.

Information Reporting

ITA
128.1(9)

New subsection 128.1(9) of the Act requires an individual who ceases to be resident in Canada after 1995 to file with the Minister of National Revenue, in prescribed form, a list of all the reportable properties that the individual owned at emigration time. This reporting requirement does not apply where the total fair market value of the individual's reportable properties at emigration time is $25,000 or less. However, where an individual owns reportable properties at emigration time with a total fair market value greater than $25,000, the individual must disclose all reportable properties on the information reporting form.

The term "reportable property" is defined in new subsection 128.1(10). For additional information, see the commentary on that subsection.

New subsection 128.1(9) applies to changes in residence that occur after 1995. The information reporting form must be filed on or before the individual's filing-due date for the year of emigration from

Canada. However, a special transitional rule accommodates individuals who cease to be resident in Canada after 1995 and before these amendments receive Royal Assent – a form filed by these transition period emigrants will be considered to have been filed in a timely manner if it is filed on or before the individual's filing-due date for the taxation year that includes the day on which Royal Assent for these amendments is received.

Definitions

ITA
128.1(10)

New subsection 128.1(10) of the Act contains two new definitions that are used in section 128.1: “excluded right or interest” and “reportable property”.

“excluded right or interest”

In general terms, an individual's excluded rights or interests include rights of the individual to future benefits or other payments under certain plans or arrangements, many of which are employer-sponsored or legislated in nature. It also includes interests of the individual in certain trusts and insurance contracts. The definition “excluded right or interest” is relevant for three main purposes.

First, the definition is relevant for paragraphs 128.1(1)(*b*) and (4)(*b*) of the Act, which treat individuals as having disposed of (and to have immediately reacquired) most of their property on immigrating to or emigrating from Canada. With one exception that applies with regard to individuals immigrating to Canada (see subparagraph 128.1(1)(*b*)(iv) for more details), excluded rights or interests are exempted from these deemed disposition rules.

Second, the definition is relevant for subclause 78(1) of the amending Notice of Ways and Means Motion, which allows individuals who emigrated from Canada after 1992 but before October 2, 1996 to elect to have their excluded rights or interests exempted from the deemed disposition rules at departure. For additional information, see the commentary on clause 78.

Third, the definition is relevant for the purpose of the information reporting requirement under new subsection 128.1(9) of the Act, which exempts from the reporting requirement certain properties that fall within the definition "excluded right or interest".

Paragraph (*a*) of the definition "excluded right or interest" refers to rights of the individual under, or an interest of the individual in a trust governed by, certain plans. The plans referred to in this paragraph include pension plans (including registered pension plans), retirement compensation arrangements, registered retirement savings plans, registered retirement income funds and foreign retirement arrangements (defined in section 6803 of the Regulations to mean certain Individual Retirement Accounts established under the United States *Internal Revenue Code*). Also included are deferred profit sharing plans, employee profit sharing plans, employee benefit plans (EBPs) (other than those described in paragraph (*b*) of this definition) and plans under which the individual has a right to receive remuneration for services rendered in the year or a previous year (including, for example, salary deferral arrangements (SDAs), unfunded bonus deferrals, self-funded leaves of absence and phantom stock plans). Registered supplementary unemployment benefit plans and registered education savings plans are also included in this paragraph.

Paragraph (*b*) of the definition refers to rights of the individual to a benefit under an EBP that would be an SDA if it were not specifically exempted from being an SDA by virtue of paragraphs (*j*) and (*k*) of the definition of "salary deferral arrangement" in subsection 248(1) of the Act or by virtue of paragraph 6801(*c*) of the Regulations. (The former exemption is for deferred salary arrangements for professional athletes, the latter for deferred salary arrangements for National Hockey League on-ice officials.) Only the right that relates to the portion of the benefit that is attributable to services rendered by the individual in Canada is included in "excluded right or interest".

Paragraph (*c*) of the definition refers to rights of the individual under an agreement referred to in subsection 7(1) or (1.1) of the Act. Those subsections refer to agreements under which employees of a corporation or of a mutual fund trust are granted certain rights to acquire shares of the corporation (or a related corporation) or units of the trust.

Paragraph (*d*) of the definition refers to rights of the individual to a retiring allowance.

Paragraph (*e*) of the definition refers to rights of the individual under, or an interest of the individual in, an employee trust, an amateur athlete trust, a cemetery care trust or a trust governed by an eligible funeral arrangement.

Paragraph (*f*) of the definition refers to rights of the individual to receive payments under an annuity contract or an income-averaging annuity contract.

Paragraph (*g*) of the definition refers to rights of the individual to benefits under the *Canada Pension Plan*, the *Québec Pension Plan*, the *Old Age Security Act* and the *Saskatchewan Pension Plan*. It also refers to rights of the individual to benefits under foreign social security arrangements.

Paragraph (*h*) of the definition refers to rights of the individual to benefits referred to in subparagraphs 56(1)(*a*)(iii) to (vi) of the Act. Those subparagraphs refer to death benefits, certain employment insurance benefits, certain benefits provided in connection with the Canada-United States Agreement on Automotive Products and prescribed benefits received under government assistance programs.

Paragraph (*i*) of the definition refers to a right of the individual to a payment out of a NISA ("net income stabilization account") Fund No. 2 under the *Farm Income Protection Act*.

Paragraph (*j*) of the definition refers to an interest of the individual in a personal trust resident in Canada, provided the interest was never acquired (by any person) for consideration and did not arise as a consequence of a transfer by the individual that would be a "qualifying disposition" under subsection 107.4(1) if that subsection were read without reference to paragraphs 107.4(1)(*h*) and (*i*). See further in this regard, the commentary on new subsections 107.4(1), 108(6) and 108(7) and new paragraph 107.4(3)(*h*). Each of these provisions is relevant for the purposes of determining the scope of paragraph (*j*).

Paragraph (*k*) of the definition refers to an interest of the individual in a non-resident testamentary trust, provided the interest was never acquired (by any person) for consideration.

Paragraph (*l*) of the definition refers to an interest of the individual in a life insurance policy in Canada (except for that part of the policy in respect of which the individual is deemed by paragraph 138.1(1)(*e*) of the Act to have an interest in a related segregated fund trust).

"reportable property"

The definition "reportable property" is relevant for the purpose of the information reporting requirement, for individuals who emigrate from Canada, under new subsection 128.1(9) of the Act.

"Reportable property" means any property of the individual other than the following:

(a) money that is legal tender in Canada and deposits of such money;

(b) property falling within the definition "excluded right or interest" in new subsection 128.1(10) of the Act, except for employee options in shares of corporations or in units of mutual fund trusts, certain interests in personal trusts resident in Canada, and interests in a life insurance policy in Canada;

(c) for individuals (other than trusts) who were resident in Canada for 60 months or less in the 120-month period that precedes the time of emigration, property, other than taxable Canadian property, that was owned by the individual before the individual became resident in Canada or that was acquired by the individual by inheritance or bequest after becoming resident in Canada; and

(d) any item of personal-use property the fair market value of which at emigration time is less than $10,000.

Clause 78

Transition

Paragraph 128.1(4)(*b*) of the Act treats a person who ceases to be resident in Canada as having disposed of most of the person's properties. The changes these amendments introduce to that deemed disposition apply, as a general matter, after October 1, 1996. However, certain of the changes are relieving clarifications of the scope of the deemed disposition. This provision allows a taxpayer who ceased to be resident in Canada after 1992 and before October 2, 1996 to elect that those relieving changes apply to that cessation of residence. In particular, an election under this provision will allow an individual who ceased to be resident in Canada after 1992 and before October 2, 1996 to rely on the new definition "excluded right or interest" in new subsection 128.1(10) of the Act in respect of that cessation of residence, for the purpose of the deemed disposition rules under subsection 128.1(4) of the Act.

It should be noted that such an election, which must be made in writing filed with the Minister of National Revenue before the end of the sixth month following Royal Assent to these amendments, will also cause certain changes to section 115 of the Act to apply. For additional information, see the commentary on section 115 and subsection 128.1(4).

Clause 79

Former Resident – Replaced Shares

ITA
128.3

New section 128.3 of the Act applies to shares ("old shares") that were received in exchange for other shares ("new shares") on a tax-deferred basis pursuant to section 51 (convertible property), subparagraphs 85.1(1)(*a*)(i) or (ii) (transfer of property to a corporation by shareholders), section 86 (exchange of shares by a shareholder in the course of a reorganization of a company's capital) or section 87 (amalgamation) of the Act. For the purposes of section 119 and subsections 126(2.21) to (2.23), 128.1(6) to (8), 180.1(1.4)

and 220(4.5) and (4.6) of the Act, the individual is deemed not to have disposed of the old shares, and the new shares are deemed to be the old shares. This ensures that the relief available under those provisions is not lost as a result of such a share-for-share exchange.

New section 128.3 applies after October 1, 1996.

Clause 82

Retention of Status as Mutual Fund Trust

ITA
132(6.2)

New subsection 132(6.2) of the Act is a rule that applies where a mutual fund trust ceases to exist. The taxation year of the mutual fund trust (determined with reference to paragraph 249(1)(*b*)) is not affected by its termination, unless paragraph 132.2(1)(*b*) applies. Consequently, the last taxation year of a mutual fund trust under the existing income tax rules is generally the calendar year in which it terminates. This leads to unintended consequences under a number of provisions of the Act (including the capital gains refund measure in subsection 132(1), the exemption from the alternative minimum tax in subparagraph 127.55(*f*)(ii) and the exemption from Part XII.2 tax in section 210.1) that require that a trust be a mutual fund trust throughout a taxation year.

New subsection 132(6.2) is intended to address these unintended consequences. A trust is deemed to be a mutual fund trust throughout a calendar year where:

- but for new subsection 132(6.2), at any time in the year the trust would have ceased to be a mutual fund trust because of the non-application of paragraph 108(2)(*a*) (i.e., units cease to be redeemable) or the application of 132(6)(*c*) (i.e., 150 unitholder requirement no longer satisfied);

- the trust was a mutual fund trust at the beginning of the year; and

- the trust would, throughout the portion of the year throughout which it was in existence, have been a mutual fund trust if

- where the condition in paragraph 108(2)(*a*) was satisfied at the beginning of the year, that condition were satisfied throughout the year, and

- paragraph 132(6)(*c*) and subsection 132(6.2) were not taken into account.

This amendment, which is similar to new subsection 250(6.1), applies to the 1990 and subsequent taxation years.

Clause 85

Insurance Corporations

The notes for paragraphs 138(11.5)(*b*), (11.91)(*e*) and (11.94)(*b*) are replaced by the following:

Transfer of Insurance Business by Non-resident Insurer

ITA
138(11.5)(b)

Subsection 138(11.5) of the Act sets out the rules that allow a non-resident insurer to transfer, on a tax-deferred basis, an insurance business carried on in Canada to a qualified related corporation. This provision is elective and, in order to be entitled to elect the rollover treatment, the conditions set out in paragraphs 138(11.5)(*a*) to (*d*) must be met. Paragraph 138(11.5)(*b*) requires that the transferor transfer all or substantially all of the property owned by it that was used or held by it in its insurance business in Canada to a qualified related corporation that commences to carry on that insurance business in Canada. The amendment to paragraph 138(11.5)(*b*) is consequential on the definition "designated insurance property" being added to subsection 138(12) and requires that the transferor transfer all or substantially all of its designated insurance property for the year to a corporation that is a qualified related corporation that commences to carry on that insurance business in Canada.

This amendment applies to the 1999 and subsequent taxation years except that, where the taxpayer or the taxpayer's representative so elects and notifies the Minister in writing before 2002 of the election,

amended paragraph 138(11.5)(*b*) of the Act will apply to the taxpayer's 1997 and subsequent taxation years.

Computation of Income of Non-resident Insurer

ITA
138(11.91)(*e*)

Subsection 138(11.91) provides rules for the purpose of computing the income of a non-resident insurer that commences to carry on an insurance business in Canada at any time in a particular taxation year or that ceases to be exempt from tax under Part I of the Act in a particular taxation year. Paragraph 138(11.91)(*e*) deems an insurer to have disposed, immediately before the beginning of the particular taxation year, of each property owned by the insurer that was used or held by it in the course of carrying on an insurance business in Canada in the year, at its fair market value and to have reacquired it at that time at that fair market value. Paragraph 138(11.91)(*e*) ensures that non-resident insurers will report the appropriate amount of gain or loss from the disposition of property used in carrying on an insurance business in Canada. Paragraph 138(11.91)(*e*) is amended to make reference to property that is designated insurance property. This amendment is consequential to the addition in subsection 138(12) of the definition “designated insurance property”, applicable to the 1997 and subsequent taxation years.

This amendment applies to the 1999 and subsequent taxation years except, that where the taxpayer or the taxpayer's representative so elects in writing and the files election with the Minister before 2002, amended paragraph 138(11.91)(*e*) will apply to the taxpayer's 1997 and subsequent taxation years.

Transfer of Insurance Business by Resident Insurer

ITA
138(11.94)(*b*)

Subsection 138(11.94) of the Act provides rules that apply to the transfer of an insurance business carried on in Canada by an insurer resident in Canada to a corporation resident in Canada that is a subsidiary wholly-owned corporation of the insurer on a tax-deferred or rollover basis. This provision can apply if the conditions set out in

paragraphs 138(11.94)(*a*) to (*d*) are met. Paragraph 138(11.94)(*b*) requires that the transferor transfer all or substantially all of the property owned by it that was used or held by it in its insurance business in Canada to a subsidiary wholly-owned corporation that commences to carry on that insurance business in Canada. Paragraph 138(11.94)(*b*) is amended to distinguish a multinational life insurer resident in Canada from other resident insurers. In regards to the former, the defined term “designated insurance property” has been substituted for “property used or held by it in the year in the course of carrying on that insurance business in Canada”. In respect of other resident insurers, the rollover provisions continue to apply in respect of “property used or held by it in the year in the course of carrying on that insurance business in Canada”.

This amendment applies to the 1999 and subsequent taxation years except that, where the taxpayer or the taxpayer's representative so elects in writing and files the election with the Minister before 2002, amended paragraph 138(11.94)(*b*) will apply to the taxpayer's 1997 and subsequent taxation years.

Clause 86

Exclusion from Taxable Canadian Property

ITA
141(5)

Under amendments contained in the 1999 budget bill (Bill C-25), new subsection 141(5) of the Act provides for shares issued by a life insurance corporation (or a holding corporation in respect of the life insurance corporation) to be considered, for the purposes of subparagraph 115(1)(*b*)(iv) of the Act, as listed on a stock exchange for up to six months after the demutualization of the life insurance corporation. As a consequence, such a share is not treated as taxable Canadian property during that period. This treatment accommodates non-resident shareholders wishing to dispose of such shares without Canadian income tax consequences before the shares become listed on a prescribed stock exchange.

Because of the relocation of the definition "taxable Canadian property" from subsection 115(1) to subsection 248(1) of the Act,

existing subparagraph 115(1)(*b*)(iv) is effectively being replaced by paragraph (*d*) of the definition "taxable Canadian property" in subsection 248(1).

This additional amendment to subsection 141(5) would simply change the reference to subparagraph 115(1)(*b*)(iv) to a reference to paragraph (*d*) of the definition "taxable Canadian property" in subsection 248(1). This amendment is intended to apply after December 15, 1998, in order to be consistent with the 1999 budget bill.

Clause 89

Miscellaneous Exemptions

ITA
149

Each coming-into-force note for the amendments to section 149 is replaced by the following:

This amendment applies to taxation years and fiscal periods that begin after 1998. However, a corporation, commission or association may, through an election in writing filed with the Minister of National Revenue within six months after this amendment is assented to, choose that this amendment apply only after November 1999.

Clause 91

Reassessments

ITA
152(6)

A number of provisions of the Act allow a taxpayer to carry back amounts from one taxation year to reduce the taxpayer's income, taxable income or tax for a prior year. Where an amount is carried back under one of these provisions, subsection 152(6) of the Act directs the Minister of National Revenue to reassess the taxpayer's tax for the relevant year or years to take the carry-back into account.

Subsection 152(6) is amended to include in its list of carry-back provisions new section 119 and new subsections 126(2.21) and (2.22) and 128.1(8) of the Act. These additions apply to taxation years that end after October 1, 1996. As well, a taxpayer who wishes to use the newly-added provisions will be deemed to have filed the prescribed form required under subsection 152(6) in a timely manner if the form is filed on or before the later of the normal deadline for filing the form and the taxpayer's filing-due date for the taxation year that includes the day on which Royal Assent for these amendments is received.

Assessment for the Purpose of Federal-Provincial Agreements

ITA
152(10)

New subsection 152(10) of the Act provides that an amount of tax for which adequate security is accepted by the Minister of National Revenue under subsection 220(4.5) or (4.6) of the Act shall not be treated as an amount assessed under the Act, for the period during which such security is accepted, for the purpose of any agreement entered into by the federal government under section 7 of the *Federal-Provincial Fiscal Arrangements Act*.

New subsection 152(10) applies to taxation years that end after October 1, 1996.

Clause 93

Interest – Effect of Carryback of Loss, etc.

ITA
161(7)(*a*)

The third paragraph of the note on this paragraph is replaced by the following:

Paragraph 161(7)(*a*) is amended to include in its list of deductions and exclusions: a deduction under new section 119 of the Act in respect of the disposition of a taxable Canadian property of the

taxpayer in a subsequent year; a deduction under new subsection 126(2.21) or (2.22) of the Act in respect of a disposition in a subsequent year; and deductions under new subsections 128.1(6) to (8) of the Act in respect of an election in a subsequent year.

Clause 94

Effect of Carryback of Loss, etc.

ITA
164(5)

The second paragraph of the note on this subsection is replaced by the following:

These amendments add to the list of deductions and exclusions: a deduction under new section 119 of the Act in respect of a disposition of taxable Canadian property by a taxpayer in a subsequent taxation year; a deduction under new subsection 126(2.21) or (2.22) in respect of foreign taxes paid for a subsequent taxation year; and deductions under new subsections 128.1(6) to (8) of the Act in respect of an election in a subsequent taxation year.

These amendments apply to taxation years that end after October 1, 1996.

Clause 98

Foreign Property Rule

ITA
206(1)

"cost amount"

Part XI of the Act provides a foreign property limit for certain taxpayers, mainly tax-exempt taxpayers such as trusts governed by registered retirement savings plans and registered pension plans. In general, a penalty tax is applied under subsection 206(2) where the total cost amount of foreign property in such a trust or plan exceeds a

specified percentage of the total cost amount of all property in the trust or plan.

Where such a taxpayer holds a capital interest in a trust, the income of the trust is usually made payable to the taxpayer so that the income is not taxed at the trust level. Arrangements have been made, however, to "capitalize" income and other amounts payable without the trust issuing new units or otherwise making a payment in satisfaction of the amounts. These arrangements are designed to maximize the indirect foreign property holdings for these unitholders by minimizing the cost amount with regard to these capital interests.

Subsection 206(1) is amended to add a special definition of "cost amount" for the purposes of Part XI. The definition is designed to increase the cost amount of a taxpayer's interest in a trust to reflect capitalized amounts payable to the taxpayer. It is also intended to amend Part L of the Regulations to make it clear that the definition also applies for this purpose.

This amendment applies after 2001.

ITA
206(4)

Subsection 206(4) of the Act provides, for the purposes of Part XI, that property acquired by a taxpayer from a person with whom the taxpayer does not deal at arm's length and for less than fair market value consideration is treated as having been acquired at its fair market value at the time of its acquisition. For these purposes, trusts that have the same beneficiary are considered not to deal with each other at arm's length.

Subsection 206(4) is amended so that it does not apply to a transfer of property to which paragraph (*f*) or (*g*) of the definition "disposition" in subsection 248(1) applies. In conjunction with subsection 248(25.1), this amendment is intended to ensure that where a transfer of property is one to which either of those paragraphs applies and that involves a taxpayer to which subsection 206(4) would otherwise apply, the transfer will occur on a rollover basis.

This amendment applies in respect of property acquired after December 17, 1999.

This amendment is part of a set of amendments intended to clarify the tax treatment of transfers of property involving RRSPs and RRIFs. For further detail, see the commentary to paragraphs 107.4(2)(*b*) and (3)(*c*), paragraphs (*f*) and (*g*) of the new definition "disposition" in subsection 248(1), and subsection 248(25.1).

Clause 100 and 101

Part XII.2

ITA
Part XII.2

Part XII.2 of the Act imposes a special tax on certain trusts resident in Canada with respect to distributions to certain beneficiaries, including non-resident beneficiaries.

ITA
210.1(*d*)

Section 210.1 of the Act provides a list of trusts to which Part XII.2 does not apply.

Paragraph 210.1(*d*) is amended to add to the list of exempt trusts a trust described in paragraph (*a*.1) of the definition "trust" in subsection 108(1). This change is strictly consequential to the introduction of paragraph (*a*.1) of that definition. For further detail on the amended definition "trust" in subsection 108(1), see the commentary on that provision.

This amendment applies to the 1999 and subsequent taxation years.

ITA
210.2(2)(*b*)

The tax under Part XII.2 of the Act is calculated with reference to a trust's "designated income" (as determined under subsection 210.2(2)). "Designated income" is calculated with reference to

taxable capital gains and allowable capital losses from dispositions of the trust's taxable Canadian property, determined on the assumption that the trust is non-resident.

Paragraph 210.2(2)(*b*) is amended to remove the assumption described above. The amendment merely simplifies paragraph 210.2(2)(*b*) and does not represent any policy change.

This amendment applies after October 1, 1996.

Clause 102

Non-resident Withholding Tax

ITA
212(1)(*c*)(i)

Paragraph 212(1)(*c*) of the Act generally provides that a non-resident beneficiary is subject to Part XIII withholding tax on trust distributions in connection with the same types of amounts on which a beneficiary resident in Canada is subject to tax under Part I.

Paragraph 212(1)(*c*) is amended to clarify that the tax consequences of a beneficiary's residence outside Canada will be taken into account in determining the amount subject to tax under paragraph 212(1)(*c*). These tax consequences include the potential indirect tax consequences to a beneficiary of a trust under subsection 104(13) of the application of subsection 107(5) to the trust because the beneficiary is non-resident.

This amendment, which is linked with new section 250.1, applies to amounts paid or credited after December 17, 1999.

Clause 105

Security for Departure Tax

Deemed Security

ITA
220(4.51)

New subsection 220(4.5) of the Act permits an individual to elect, on giving adequate security to the Minister of National Revenue, to defer payment of an amount of tax that is owing as a result of the deemed disposition of a particular property in paragraph 128.1(4)(*b*) of the Act. New subsection 220(4.51) treats an individual (other than a trust) as having furnished acceptable security to the Minister for the lesser of two amounts. The first amount is the total amount of taxes under Parts I and I.1 of the Act that would be payable, at the highest tax rate that applies to individuals, on a taxable capital gain of $67,000. (For administrative simplicity, this amount is described in the provision as the amount of those taxes that an *inter vivos* trust would pay for a year if the trust's taxable income for the year were $67,000.)

The second amount is the greatest amount of tax for which the Minister is required to accept security under subsection 220(4.5) for any particular taxation year of the individual. The deemed security is treated as having been furnished by the individual before the individual’s balance-due day for the year in which the individual ceased to be a resident of Canada.

The effect of this provision is to excuse individual emigrants (other than trusts) from the requirement to provide security for an amount at least equal to the taxes payable on their first $100,000 of capital gains ($67,000 of taxable capital gains) resulting from the deemed disposition on emigration.

New subsection 220(4.51) applies after October 1, 1996. To reflect the three-quarters inclusion rate for capital gains that applies before the 2000 federal budget, a transitional rule provides that the amount "$67,000" in new paragraph 220(4.52)(*a*) shall be read as "$75,000" in respect of emigration years that are before 2001.

Clause 112

Interpretation

Definitions

ITA
248(1)

"taxable Canadian property"

The second-to-last paragraph of the note on this definition is replaced by the following:

Two additional points should be noted with respect to this new definition. First, in addition to listing the above types of property, the new definition preserves in its paragraphs (*m*) to (*q*) the extended meaning of "taxable Canadian property." That extended meaning now applies for the purposes of section 2, subsection 107(2.001), sections 128.1 and 150 of the Act, and for the purpose of applying paragraphs 85(1)(*i*) and 97(2)(*c*) of the Act to a disposition by a non-resident person. For these purposes, "taxable Canadian property" includes Canadian resource properties, timber resource properties, income interests in trusts resident in Canada, rights to a share of the income or loss under an agreement referred to in paragraph 96(1.1)(*a*) of the Act, and life insurance policies in Canada. Second, the new definition does not include, as the existing one does, property that is not otherwise defined to be taxable Canadian property but that rather is deemed by another provision of the Act to be so. That distinction remains relevant, but the rewording of the definition "excluded property" in subsection 116(6) of the Act makes it unnecessary here.

"*alter ego* trust"

"joint partner trust"

"post-1971 partner trust"

The new definition "*alter ego* trust" in subsection 248(1) of the Act refers to a trust to which paragraph 104(4)(*a*) would apply if that paragraph were read without reference to subparagraph 104(4)(*a*)(iii)

and clause 104(4)(*a*)(iv)(B). Accordingly, for a trust to be an *alter ego* trust it must satisfy the following conditions:

1. at the time of the trust's creation, the taxpayer creating the trust was alive and had attained 65 years of age;

2. the trust was created after 1999;

3. the taxpayer was entitled to receive all of the income of the trust that arose before the taxpayer's death;

4. no person except the taxpayer could, before the taxpayer's death, receive or otherwise obtain the use of any of the income or capital of the trust; and

5. the trust did not make an election referred in subparagraph 104(4)(*a*)(ii.1).

The definition "joint partner trust" refers to a trust to which paragraph 104(4)(*a*) would apply if that paragraph were read without reference to subparagraph 104(4)(*a*)(iii) and clause 104(4)(*a*)(iv)(A). Accordingly, for a trust to be a joint partner trust it generally must satisfy the following conditions:

1. at the time of the trust's creation, the taxpayer creating the trust was alive and had attained 65 years of age;

2. the trust was created after 1999;

3. the taxpayer or the taxpayer's spouse was, in combination with the spouse or the taxpayer, as the case may be, entitled to receive all of the income of the trust that arose before the later of the death of the taxpayer and the death of the spouse; and

4. no other person could, before the later of those deaths, receive or otherwise obtain the use of any of the income or capital of the trust.

The new definition "post-1971 partner trust" refers to a trust that would be described in paragraph 104(4)(*a*) if that paragraph were read without reference to subparagraph 104(4)(*a*)(iv). Accordingly, a

post-1971 partner trust must generally satisfy the following conditions:

1. it is a trust under which only the taxpayer's spouse is entitled to receive all of the income of the trust that arose before the spouse's death; and

2. no person except the spouse could, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust.

Unlike *alter ego* trusts and joint partner trusts (referred to in the commentary above), a post-1971 partner trust may also be created by a taxpayer's will.

The definitions "*alter ego* trust" and "joint partner trust" apply to trusts created after 1999. The definition "post-1971 partner trust" applies to trusts created after 1971. Other amendments related to the introduction of these definitions include amendments to section 73, subsections 104(5.8), (6) and (15) and subsection 107(4), and the amended definition of "trust" in subsection 108(1). For further detail, see the commentary on those provisions.

These amendments also reflect changes proposed under Bill C-23, the *Modernization of Benefits and Obligations Act.*

"disposition"

The new definition of "disposition" in subsection 248(1) of the Act replaces a definition of the same expression in section 54. The new definition applies for the purposes of the entire Act.

The table below briefly compares the new definition with the former definition, with further detail provided below with regard to the policy changes introduced by the new definition. The first column and second column indicate paragraph references in the new definition and the former definition, respectively. Except as indicated otherwise below, these amendments apply to transactions and events that occur after December 23, 1998.

New	Old	Description
(*a*)	(*a*)	Disposition of property by a taxpayer includes transaction or event entitling taxpayer to proceeds. No policy change.
(*b*)	(*b*)	Specified redemptions, cancellations, conversions and expirations of debt, equity and options treated as dispositions. No policy change.
(*c*)	(*c*)	Except as otherwise specified, dispositions include transfers to and from trusts. No policy change.
(*d*), (*h*) and (*i*)	N/A	Circumstances in which distribution by a trust constitutes disposition of a capital interest in a trust. See description below.
(*e*) and (*f*)	(*e*)	Circumstances in which a transfer not a disposition because no change in beneficial ownership. Under the new rules, these circumstances are narrower. See also amended subsection 104(1).
(*g*)	N/A	Circumstances in which transfers involving RRSPs and RRIFs of the same annuitant not a disposition. See description below.
(*j*)	(*d*)	Transfer to secure debt not a disposition. No policy change.
(*k*)	N/A	Other transfers to secure obligations not a disposition. See description below.
(*l*)	(*f*)	Issue of debt not a disposition. No policy change, but minor technical change. See description below.
(*m*)	(*g*)	Issue of share not a disposition. No policy change.

Transactions involving capital interests in a trust

Paragraph (*d*) of the new definition applies with respect to capital interests in a trust. Paragraph (*d*) makes it clear that, except as specifically provided in paragraph (*h*) or (*i*), every payment (in kind or otherwise) by a trust to a taxpayer in respect of the taxpayer's capital interest (as defined in subsection 108(1)) in the trust will result in a disposition of all or part of the taxpayer's capital interest in the trust.

The exception under paragraph (*h*) applies to a payment made by a trust after 1999 where the following conditions are satisfied:

1. the capital interest in the trust is described by reference to units issued by the trust;

2. the payment does not result in a reduction of the number of units in the trust owned by the taxpayer; and

3. the trust is neither a personal trust nor a trust prescribed for the purpose of subsection 107(2).

The exception under paragraph (*i*) applies to a payment made by a trust after 1999 where the following conditions are satisfied:

1. the payment is made out of the trust's income (determined without reference to subsection 104(6)) or capital gains for a taxation year and the payment was made in the year or the right to the payment was acquired in the year; and

2. the payment is in respect of an amount designated by the trust under subsection 104(20).

Paragraphs (*d*), (*h*) and (*i*) are part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. Generally, results achieved under these rules are intended to accord with existing income tax practice. For further detail, see the notes on amendments to subsections 43(2), 52(6), 107(2) and (2.1) and the definition "capital interest" in subsection 108(1).

Transactions involving no change in beneficial ownership of property

Paragraph (*e*) of the new definition provides that there is no disposition where a transfer of property does not involve a trust and does not result in a change in the beneficial ownership of the property. Where any of the exceptions in subparagraphs (*e*)(i) to (iii) apply, paragraph (*c*) of the definition will ensure a disposition subject to the exceptions in paragraph (*c*). Paragraph (*e*) takes into account past interpretations of the definition "disposition" in section 54. For example, the CCRA has taken the position that there is no disposition where an individual's undivided joint ownership interest in real property is converted to a tenancy-in-common interest in the property.

Paragraph (*f*) of the new definition provides an exception to the general rule in paragraph (*c*) that a disposition results from any transfer of the property to a trust or, where the property is property of a trust, any transfer of the property to any beneficiary under the trust. Paragraph (*f*) avoids, unless an election is made to the contrary under subparagraph (*f*)(v), a disposition in the case of certain very simple trust-to-trust transfers involving no change in beneficial ownership. For this paragraph to apply, the following additional conditions must be satisfied:

1. the transfer is not from a trust resident in Canada to a non-resident trust;

2. the transferee does not receive the property in satisfaction of the transferee's right as a beneficiary under the transferor trust;

3. the transferee does not hold property immediately before the transfer other than property the cost of which is not included, for the purposes of the Act, in computing a balance of undeducted outlays, expenses or other amounts in respect of the transferee (i.e., subject to subparagraph (*f*)(vii) described in item 6 below, the transferee would be permitted to hold non-depreciable capital property);

4. where the transferor is an amateur athlete trust, a cemetery care trust, an employee trust, an *inter vivos* trust deemed by subsection 143(1) to exist in respect of a congregation that is a constituent part of a religious organization, a related segregated fund trust (in this paragraph having the meaning assigned by section 138.1), a

trust described in paragraph 149(1)(*o*.4) or a trust governed by an eligible funeral arrangement, an employees profit sharing plan, a registered education savings plan or a registered supplementary unemployment benefit plan, the transferee is the same type of trust;

5. the transfer results, or is part of a series of transactions or events that results, in the transferor ceasing to exist; and

6. at all times before the transfer or before the beginning of that series of transactions or events, as the case may be, the transferee held no property or held only property having a nominal value.

Paragraph (*f*) generally will not apply to a transfer of property that occurred before 2000 by an RRSP trust to a RRIF trust (or by a RRIF trust to an RRSP trust), unless the transferee trust files a written election with the Minister of National Revenue on or before the filing-due date for its taxation year in which the transfer is made (or on such later day as is acceptable to the Minister) that paragraph (*f*) of that definition applies. For transfers of property involving RRSPs and RRIFs and that occur after 1999, where the conditions of paragraph (*f*) are satisfied, that paragraph will apply to avoid a disposition without need for an election. For further detail, see the commentary on paragraph (*g*) of the definition.

Where paragraph (*f*) does apply, new subsection 248(25.1) applies with tax consequences described in the commentary on that subsection. Where the paragraph does not apply because the six additional conditions described above are not satisfied (and paragraph (*g*) also does not apply), the transfer will generally be a qualifying disposition under new subsection 107.4(1).

Paragraph (*k*) of the new definition also applies to a transfer of property as a consequence of which there is no change in the beneficial ownership of the property. For paragraph (*k*) to apply with no resulting disposition resulting from the transfer of property, the main purpose of the transfer must be:

- to effect payment under a debt or loan;

- to provide comfort that an absolute or contingent obligation of the transferor will be satisfied; or

- to facilitate either the provision of compensation or the enforcement of a penalty, in the event that an absolute or contingent obligation of the transferor is not satisfied.

Where paragraph (*k*) applies, new subsection 248(25.2) applies with tax consequences described in the commentary on that subsection.

Transactions involving RRSPs and RRIFs

Paragraph (*g*) also provides an exception to the general rule in paragraph (*c*) that a disposition results upon the transfer of property to a trust or transfers of property from a trust to a beneficiary of the trust. Paragraph (*g*) of the new definition avoids, unless an election is made to the contrary under subparagraph (*g*)(v), a disposition in the case of certain trust-to-trust transfers involving RRSPs and RRIFs. A transfer under this paragraph is not subject to the restriction in paragraph (*f*) that there be no change in beneficial ownership. For paragraph (*g*) to apply, the following additional conditions must be satisfied:

1. the transferor is an RRSP trust or RRIF trust;

2. the transferee is an RRSP trust or RRIF trust;

3. the transferee does not hold property immediately before the transfer other than property the cost of which is not included, for the purposes of the Act, in computing a balance of undeducted outlays, expenses or other amounts in respect of the transferee (i.e., subject to subparagraph (*g*)(vi) described in item 5 below, the transferee would be permitted to hold non-depreciable capital property);

4. the transfer results, or is part of a series of transactions or events that results, in the transferor ceasing to exist; and

5. at all times before the transfer or before the beginning of that series of transactions or events, as the case may be, the transferee held no property or held only property having a nominal value.

Paragraph (*g*) generally will not apply to a transfer of property that occurred before 2000 by an RRSP trust of an annuitant to a RRIF

trust of the same annuitant (or by a RRIF trust of an annuitant to an RRSP trust of the same annuitant), unless the transferee trust files a written election with the Minister of National Revenue on or before the filing-due date for its taxation year in which the transfer is made (or on such later day as is acceptable to the Minister) that paragraph (*g*) of that definition applies. For transfers of property involving RRSPs and RRIFs that occur after 1999 and that satisfy the requirements of paragraph (*g*), the paragraph will apply to avoid a disposition without need for an election.

Where paragraph (*g*) applies, new subsection 248(25.1) applies with tax consequences described in the commentary on that subsection. Where neither paragraph (*f*) nor (*g*) applies, the transfer will generally be a qualifying disposition under new subsection 107.4(1) provided the conditions of that provision are met.

EXAMPLE 1

Imelda arranged the transfer of properties in November 1999 from the RRSP trust under which she was the annuitant to a RRIF trust under which she was the annuitant. Under the RRSP trust the only named beneficiary was Luc. However, under the RRIF trust, Imelda named Gilbert as a beneficiary.

Results:

1. Because the transfer occurred after December 23, 1998 but before 2000, it will constitute a disposition under paragraph (c) of the definition "disposition", unless the RRIF trust files an election that paragraph (g) of that definition applies (paragraph (f) of that definition is intended not to apply where there is a change in beneficial ownership upon the transfer). If the election is filed and the remaining conditions in paragraph (g) are met, the transfer will not be a disposition. However, because of subsection 206(4), the transfer would be expected to occur on a fair market value basis.

2. If the election referred to in item 1 above is not filed, the transfer will be a "qualifying disposition" if the conditions of subsection 107.4(1) are met. For this purpose, paragraph 107.4(2)(b) deems there to be no change in beneficial ownership if the annuitant under the transferor trust is the same individual as

the annuitant under the transferee trust. If the transfer is a "qualifying disposition", under subparagraph 107.4(3)(c)(iii) the transfer will occur on a fair market value basis unless subparagraph 107.4(3)(c)(i) applies.

3. This result reflects the intent that transfers between RRSPs and RRIFs of the same annuitant that occur before 2000 generally occur on a fair market value basis.

EXAMPLE 2

Lucie arranged the transfer of properties in March 2000 from the RRSP trust under which she was the annuitant to a RRIF trust under which she was the annuitant. Under the RRSP trust the only named beneficiary was Paulette. However, under the RRIF trust, Lucie named Jamal as the beneficiary.

Results:

1. Because the transfer occurred after 1999, if the conditions of paragraph (g) of the definition "disposition" are met, the transfer will not be a disposition unless an election is filed by the transferee under subparagraph (g)(v). (Paragraph (f) of that definition is intended not to apply where there is a change in beneficial ownership upon the transfer). The combined effect of amended subsection 206(4), which expressly does not apply to a transfer described in paragraph (g) of the definition "disposition", and new subsection 248(25.1), which provides that the transferee trust is a continuation of the transferor trust, will ensure the intended result that the transfer occur on a rollover basis.

2. If the transferee trust elects out of paragraph (g) of the definition "disposition", the transfer will be a "qualifying disposition" if the conditions of subsection 107.4(1) are met. For this purpose, paragraph 107.4(2)(b) deems there to be no change in beneficial ownership if the annuitant under the transferor is the same individual as the annuitant under the transferee. If the transfer is a "qualifying disposition", then under subparagraph 107.4(3)(c)(iv) the transfer will occur on a rollover basis unless subparagraph 107.4(3)(c)(ii) applies.

3. This result reflects the intent that transfers between RRSP and RRIF trusts of the same annuitant that occur after 2000 generally occur on a rollover basis.

Paragraph (*g*) of the definition is part of a set of amendments intended to clarify the tax treatment of transfers of property involving RRSPs and RRIFs. For further detail, see the commentary to paragraphs 107.4(2)(*b*) and (3)(*c*), subsection 206(4), the new definition "disposition" in subsection 248(1) and subsection 248(25.1).

Other transactions

Paragraph (*l*) of the definition replaces paragraph (*f*) of the definition "disposition" in subsection 54(1), which is repealed. Paragraph (*l*) adds a reference to "hypothec". This amendment is made to ensure that the Act appropriatly reflects both the civil law of the province of Quebec and the law of other provinces.

Except as indicated otherwise above, these amendments apply to transactions and events that occur after December 23, 1998.

ITA
248(25.1)

New subsection 248(25.1) of the Act applies where there is a transfer of a property from a particular trust to another trust in circumstances to which paragraph (*f*) or (*g*) of the definition "disposition" in subsection 248(1) (explained in the notes above) applies. The result of the application of either of those paragraphs is that the transfer does not constitute a disposition. Where this is the case, subsection 248(25.1) deems the other trust after the particular time to be the same trust as, and a continuation of, the particular trust.

The application of subsection 248(25.1) does not affect the personal liabilities under this Act of the trustees of either trust or the application of subsection 104(5.8) or paragraph 122(2)(*f*).

This amendment applies to transfers that occur after December 23, 1998.

ITA
248(25.2)

Subsection 248(25.2) of the Act applies where at any time there is a transfer of property to a trust in circumstances to which paragraph (*k*) of the definition "disposition" in subsection 248(1) applies. Once the property has been transferred, the trust is deemed to deal with the property as agent for the transferor until there is a subsequent change in its beneficial ownership.

This amendment applies to transfers that occur after December 23, 1998.

ITA
248(25.3)

Subsection 248(25.3) of the Act applies where a trust (other than a personal trust or a trust prescribed for the purpose of subsection 107(2)) issues particular units of the trust to a taxpayer directly in satisfaction of a right to a qualifying amount payable from the trust in respect of the taxpayer's capital interest in the trust. Where this is the case, the cost to the taxpayer of the particular units is deemed to equal the amount so payable. In the case of particular units of a trust that are capital property, a qualifying amount payable is one that causes, or but for clauses 53(2)(*h*)(i.1)(A) and (B) would cause, a reduction under subparagraph 53(2)(*h*)(i.1) to the adjusted cost base of the taxpayer's capital interest. Where the particular units of a trust are not capital property, a qualifying amount payable is one in respect of which subparagraph 53(2)(*h*)(i.1) does not apply but to which that subparagraph would apply if it were read without reference to clauses 53(2)(*h*)(i.1)(A) and (B).

This amendment applies to the 1999 and subsequent taxation years.

ITA
248(25.4)

Subsection 248(25.4) of the Act provides relief from possible double taxation where a taxpayer disposes to another person or a partnership a capital interest in a trust that includes a right to enforce payment of an amount by the trust. If, had the trust satisfied the right, there would have been no disposition of the right because of paragraph (*i*)

of the definition "disposition" in subsection 248(1), the amount is added to the cost otherwise determined immediately before the disposition of the taxpayer's capital interest in the trust.

This amendment applies to transfers that occur after December 23, 1998.

EXAMPLE

Stephanie's capital interest in a unit trust initially consists of 1,000 units that Stephanie purchased on December 23, 2000 for \$10,000. The trust has not made an election under subsection 132.11(1) to have a December 15 year end. It makes \$400 of its income for its 2000 taxation year payable to Stephanie on December 31, 2000. However, prior to the satisfaction of Stephanie's assignable right to enforce payment of the \$400 amount payable, Stephanie sells 1/2 of her capital interest in the trust (i.e., 500 units and 1/2 of the right to enforce payment) to a 3rd party for \$5,700.

Results:

1. Under subsection 104(13), Stephanie is required to include \$400 in computing her income for the 2000 taxation year.

2. The right to enforce payment of the \$400 amount by the trust is treated as part of Stephanie's capital interest in the trust under subsection 108(1). Under paragraph (i) of the definition "disposition" in subsection 248(1), a payment by the trust in satisfaction of the right would not be a disposition. However, the sale of the 500 units in the trust is a disposition of part of Stephanie's capital interest that includes a part of her right to enforce payment from the trust.

3. As the ACB of the right disposed of is nil, Stephanie realizes a gain of \$200 (i.e., 1/2 of the total amount to which the right to enforce relates) upon its sale to the 3rd party. Subsection 248(25.4) is intended to apply in these circumstances to provide a \$200 "bump" in the ACB of her capital interest in the trust otherwise determined immediately before the disposition. Consequently, the total ACB of the 500 units sold is \$5,200 (i.e., \$5,000 + \$200).

4. Consequently, the capital gain realized on the disposition of the 500 units is $500 ($5,700- $5,200).

Clause 115

Non-resident Person's Taxation Year and Income

ITA
250.1

New section 250.1 of the Act contains clarifying rules that apply for greater certainty, unless the context requires otherwise.

New paragraph 250.1(*a*) provides that, unless the Minister of National Revenue provides otherwise, the taxation year of a non-resident person is determined in the same manner as that of a person resident in Canada.

New paragraph 250.1(*b*) clarifies that a person for whom "income" for the year is determined in accordance with the Act includes a non-resident person. It is a non-resident person's "taxable income earned in Canada" that is relevant for the purposes of computing the person's tax liability under Part I. However, a non-resident person does, in some narrow cases, have "income" for purposes of the Act. For example, there are references to a non-resident's "income" (rather than "taxable income earned in Canada") in paragraphs 212(1)(*c*) and 216(1)(*b*) and subparagraph 217(3)(*b*)(ii). In addition, the "income" of a non-resident person may affect the tax liability of a person resident in Canada (e.g., subsection 104(13)).

New section 250.1 applies after December 17, 1999.

Clause 116

Arm's Length

ITA
251(1)

Section 251 of the Act defines the circumstances in which persons are considered not to deal with each other at arm's length for the purposes of the Act.

Subsection 251(1) is amended to ensure that a taxpayer and a specified personal trust (i.e., a personal trust other than one described in any of paragraphs (*a*) to (*e*.1) of the definition "trust" in subsection 108(1)) are deemed not to deal with each other at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, is beneficially interested in the trust. (In determining whether a person is "beneficially interested" in a trust for this purpose, subsection 248(25) is read without reference to subclauses 248(25)(*b*)(iii)(A)(II) to (IV), which provide an extended meaning of this expression.) The non-arm's length relationship is relevant, for example, in applying amended subsection 69(1).

This amendment applies after December 23, 1998, but for the purpose of applying the definition "taxable Canadian property" in subsection 248(1) of the Act it applies only in respect of property acquired after December 23, 1998.

Clause 117

Investments in Limited Partnerships

ITA
253.1

New section 253.1 of the Act applies for the purposes of subparagraph 108(2)(*b*)(ii) (definition of "unit trust"), the definition "non-resident investment fund" in subsection 115.2(1), paragraphs 130.1(6)(*b*) (definition of "mortgage investment corporation"), 131(8)(*b*) (definition of "mutual fund corporation") and 132(6)(*b*) (definition of "mutual fund trust") and the definition "private holding

corporation" in subsection 191(1), where a trust or corporation holds an interest as a limited partner in a limited partnership. Section 253.1 also applies for the purposes of regulations made for the purpose of paragraph 149(1)(*o*.3) (i.e., section 5101 of the Regulations and paragraph 149(*o*.4) (i.e., section 5001 of the Regulations). These regulations define the expressions "small business investment corporation "and "master trust".

For the purposes of applying the above-noted provisions and definitions where a trust, corporation or partnership is a member of a particular limited partnership, the member is deemed

- to undertake an investing of its funds because of its acquisition and holding of its interest as a member of the particular partnership, and

- not to carry on any business or other activity of the particular partnership.

This amendment ensures that the holding of a limited partnership interest by a trust or corporation will not jeopardize the classification of the trust or corporation under specified definitions of the Act and the Regulations. It responds, in part, to the reasoning of the Federal Court of Appeal in *Robinson (Trustee of) v. R.*, [1998] 1 CTC 272, 98 DTC 6065, which, in another context, clarified that limited partners carry on the business of a partnership. As a consequence of this amendment, the meanings of the specified definitions will be determined with reference to new section 253.1 wherever the definitions are used in the Act or Regulations.

This amendment is not, however, intended to suggest that ownership of a unit as a limited partner in a limited partnership is not otherwise an investment for the purposes of the Act. For example, in applying paragraph 149(1)(*o*.2), it is intended that an interest held by a corporation as a limited partner in a limited partnership be treated as an investment of the corporation.

This amendment applies after 1992.

Clause 121

Taxable Capital Employed in Canada – Life Insurance Corporations

S.C. 1998, c. 19, s. 206

Subsection 190.1(1.1) of the *Income Tax Act* imposes an additional temporary Part VI tax on the taxable capital employed in Canada of life insurance corporations. Section 206 of the *Income Tax Amendments Act, 1997* provided that deferred realized gains and losses of life insurance corporations on investment properties would not be added or deducted in computing the Part VI tax base. Consequential on the extension of the additional tax to December 31, 2000, this amendment extends the exclusion of deferred realized gains and losses in calculating the Part VI tax base to the same date.

This amendment applies to taxation years that end after 1998.